NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

CIS Congressional Information Service
Washington, D.C.

CONSUMER PRICE INDEX MEASURE USED IN CALCULATING SOCIAL SECURITY COST-OF-LIVING ADJUSTMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

APRIL 26, 1989

Serial 101-9

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

99-596 WASHINGTON : 1989

H781-62

COMMITTEE ON WAYS AND MEANS

DAN ROSTENKOWSKI, Illinois, *Chairman*

SAM M. GIBBONS, Florida
J. J. PICKLE, Texas
CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ANDREW JACOBS, JR., Indiana
HAROLD FORD, Tennessee
ED JENKINS, Georgia
RICHARD A. GEPHARDT, Missouri
THOMAS J. DOWNEY, New York
FRANK J. GUARINI, New Jersey
MARTY RUSSO, Illinois
DON J. PEASE, Ohio
ROBERT T. MATSUI, California
BERYL ANTHONY, JR., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut
BRIAN J. DONNELLY, Massachusetts
WILLIAM J. COYNE, Pennsylvania
MICHAEL A. ANDREWS, Texas
SANDER M. LEVIN, Michigan
JIM MOODY, Wisconsin

BILL ARCHER, Texas
GUY VANDER JAGT, Michigan
PHILIP M. CRANE, Illinois
BILL FRENZEL, Minnesota
DICK SCHULZE, Pennsylvania
BILL GRADISON, JR., Ohio
WILLIAM M. THOMAS, California
RAYMOND J. McGRATH, New York
HANK BROWN, Colorado
ROD CHANDLER, Washington
E. CLAY SHAW, JR., Florida
DON SUNDQUIST, Tennessee
NANCY L. JOHNSON, Connecticut

ROBERT J. LEONARD, *Chief Counsel and Staff Director*
PHILLIP D. MOSELEY, *Minority Chief of Staff*

SUBCOMMITTEE ON SOCIAL SECURITY

ANDY JACOBS, JR., Indiana, *Chairman*

RICHARD A. GEPHARDT, Missouri
SAM M. GIBBONS, Florida
SANDER M. LEVIN, Michigan
JIM MOODY, Wisconsin

HANK BROWN, Colorado
DICK SCHULZE, Pennsylvania
BILL GRADISON, Ohio

CONTENTS

	Page
Press release of Monday, April 10, 1989, announcing the hearing	2
Background material	4

WITNESSES

U.S. Department of Labor, Bureau of Labor Statistics, Janet L. Norwood, Commissioner, and Kenneth Dalton, Associate Commissioner for Prices and Living Conditions	6
Social Security Administration, Harry C. Ballantyne, Chief Actuary	17
Congressional Budget Office, Frederick C. Ribe, Assistant Director for Fiscal Analysis, Robert Dennis, Deputy Assistant Director for Fiscal Analysis, and Paul Cullinan, analyst	21
American Association of Retired Persons, George Zimmerman	36
Save Our Security Coalition, Arthur S. Flemming	30

SUBMISSIONS FOR THE RECORD

Mercer Meidinger Hansen, Inc., Social Security Division, Louisville, KY, Bruce D. Schobel, statement	47
National Association of Retired Federal Employees, statement	50
National Committee To Preserve Social Security and Medicare, Martha McSteen statement	53
Pryor, Hon. David, a U.S. Senator from the State of Arkansas and chairman, Senate Special Committee on Aging, statement	55

CONSUMER-PRICE-INDEX MEASURE USED TO CALCULATE SOCIAL SECURITY COST-OF-LIVING ADJUSTMENTS

WEDNESDAY, APRIL 26, 1989

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SOCIAL SECURITY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room B-318, Rayburn House Office Building, Hon. Andy Jacobs, Jr. (chairman of the subcommittee) presiding.

[The press release announcing the hearing and background material follow:]

FOR IMMEDIATE RELEASE
MONDAY, APRIL 10, 1989

PRESS RELEASE #4
SUBCOMMITTEE ON SOCIAL SECURITY
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-9263

THE HONORABLE ANDY JACOBS, JR. (D., IND.), CHAIRMAN,
SUBCOMMITTEE ON SOCIAL SECURITY,
COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A HEARING ON
THE CONSUMER-PRICE-INDEX MEASURE USED IN
CALCULATING SOCIAL SECURITY COST-OF-LIVING ADJUSTMENTS

The Honorable Andy Jacobs, Jr. (D., Ind.), Chairman of the Subcommittee on Social Security, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing on the consumer-price-index measure used to calculate cost-of-living adjustments in social security benefits. The hearing will be held on Wednesday, April 26, 1989, beginning at 10:00 a.m., in room B-318 Rayburn House Office Building.

Oral testimony will be heard from invited witnesses only. The witnesses will include representatives from the Bureau of Labor Statistics of the Department of Labor, the Social Security Administration, the Congressional Budget Office, and organizations representing social security beneficiaries. Any individual or organization may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

BACKGROUND

In 1972, Congress adopted legislation to provide for automatic cost-of-living adjustments (COLA's) in social security benefits, to be determined according to the consumer price index (CPI) published by the Department of Labor. The only CPI published at the time the law was enacted was the CPI-W, which measures the cost-of-living of urban wage earners and clerical workers. It has been published since 1919 and includes approximately 32 percent of the U.S. population.

In 1978, the Department of Labor introduced a new CPI, the CPI-U. Unlike the CPI-W, the CPI-U covers all households in urban areas. It measures the cost-of-living of all urban consumers and covers approximately 80 percent of the total U.S. population. Seventy-seven percent of noninstitutionalized social security beneficiaries live in households covered by the CPI-U.

Some advocates for senior citizens have voiced concern about the appropriateness of the CPI-W as a measure of the inflation experienced by social security beneficiaries. Some economists and statisticians believe that the CPI-U would be a more accurate gauge of the inflation experienced by this group.

The hearing will address the following items: the calculation and periodic adjustment of the CPI-W and the CPI-U; reasons for differing results under the two indices; performance of the indices under varying economic conditions; and the program cost of adopting the CPI-U as the official inflation measure for the social security program.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written statements for the printed record of the hearing should submit six (6) copies by the close of business, Wednesday, May 10, 1989, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing a written statement for the record of the printed hearing wish to have their statements distributed to the press and the interested public at the hearing, they may provide additional copies for this purpose to the Subcommittee office, room B-316 Rayburn House Office Building, on the day of the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will **not** be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

ANDY JACOBS, JR., INDIANA, CHAIRMAN
SUBCOMMITTEE ON SOCIAL SECURITY

RICHARD A. GEPHARDT, MISSOURI
SAM M. GIBBONS, FLORIDA
BARBER B. CONABLE, JR., NEW YORK
BILL ARCHER, TEXAS
JIM MOODY, WISCONSIN

HANK BROWN, COLORADO
DICK SCHULZE, PENNSYLVANIA
BILL GRADISON, OHIO

Ex Officio:
DAN ROSTENKOWSKI, ILLINOIS
WILLIAM M. BRODY, TEXAS

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515
SUBCOMMITTEE ON SOCIAL SECURITY

DAN ROSTENKOWSKI, ILLINOIS, CHAIRMAN
COMMITTEE ON WAYS AND MEANS

ROBERT J. LEONARD, CHIEF COUNSEL AND
STAFF DIRECTOR
SANDRA CASSER WISE, SUBCOMMITTEE STAFF DIRECTOR

PHILLIP D. MOSELEY, MINORITY CHIEF OF STAFF
KAREN K. WORTH, SUBCOMMITTEE MINORITY

April 14, 1989

Memorandum

TO: Members of the Subcommittee

FROM: Sandra Casber Wise
Staff Director

REGARDING: April 26 hearing on consumer price index measure used to calculate the social security cost-of-living adjustment

On Wednesday, April 26 at 10:00 a.m., the Subcommittee on Social Security will hold a hearing on the consumer price index measure used to calculate cost-of-living adjustments in social security.

Background

Congress adopted legislation in 1972 to provide automatic COLA's for social security benefits, to be determined according to the consumer price index (CPI) published by the Department of Labor. The only CPI published at the time the law was enacted was the CPI-W, which measures the cost-of-living of urban wage earners and clerical workers. This measure has been published since 1919 and includes approximately 32 percent of the U.S. population.

In 1978, the Department of Labor introduced a new CPI, the CPI-U. Unlike the CPI-W, the CPI-U covers all households in urban areas. It measures the cost-of-living of all urban consumers and covers approximately 80 percent of the total U.S. population. Seventy-seven percent of noninstitutionalized social security beneficiaries live in households covered by the CPI-U.

Some advocates for senior citizens have voiced concern about the appropriateness of the CPI-W as a measure of the inflation experienced by social security beneficiaries. Some economists and statisticians believe that the CPI-U would be a more accurate gauge of the inflation experienced by this group.

A six-year comparison of the CPI-W and the CPI-U shows slightly larger growth in the CPI-U in four of the six years:

	CPI-W	CPI-U	Difference
1983	3.3%	3.8%	+ .5
1984	3.5	3.9	+ .4
1985	3.6	3.8	+ .2
1986	0.6	1.1	+ .5
1987	4.5	4.4	- .1
1988	4.4	4.4	0
1983-1988	19.9	21.4	+1.5

Witnesses

Only invited witnesses will be heard at the Subcommittee hearing. They include the Bureau of Labor Statistics, the Social Security Administration, the Congressional Budget Office, and representatives of social security beneficiaries.

Chairman JACOBS. Today's hearing is on the subject of how most accurately to measure cost-of-living adjustments, which is not to say increases, in Social Security benefits. Let us proceed.

At this point, we will insert in the record the statement of Mr. Brown.

[The statement of Mr. Brown follows:]

OPENING STATEMENT OF HON. HANK BROWN

Mr. Chairman, I'm pleased that the committee will have a chance today to hear the testimony of these witnesses on this important issue.

From the viewpoint of a Social Security beneficiary, one can appreciate the importance of today's hearing. The COLA is an essential feature of Social Security benefits, because it helps to protect a retiree's standard of living.

It is therefore important that change in the cost of living be measured as accurately as possible. I understand there is much support for using the CPI-U, the measurement of urban households, rather than the current CPI-W, which measures the cost of living for urban wage earners and clerical workers. I'm sure today's witnesses will speak to this point.

I want to thank today's witnesses for helping us understand the issue more clearly.

Chairman JACOBS. Our first witness is Janet Norwood, Ph.D., from the Bureau of Labor Statistics. Doctor, would you come forward and edify us?

STATEMENT OF JANET L. NORWOOD, PH.D., COMMISSIONER, BUREAU OF LABOR STATISTICS, U.S. DEPARTMENT OF LABOR, ACCOMPANIED BY KENNETH DALTON, ASSOCIATE COMMISSIONER FOR PRICES AND LIVING CONDITIONS

Ms. NORWOOD. Thank you very much, Mr. Chairman. I have with me Kenneth Dalton, who is the Associate Commissioner for Prices and Living Conditions at the Bureau of Labor Statistics.

We are both very pleased to be here. As you quite rightly have pointed out, the Bureau of Labor Statistics does produce two Consumer Price Indexes, one for urban wage earners and clerical workers, the CPI-W, and the other for all urban consumers, the CPI-U.

The CPI-W is a continuation of the historical index, which was initiated really during World War I in order to provide data for wage negotiations. It is based on the expenditures of urban consumer units which meet particular employment requirements.

More than one-half of the consumer unit's income has to be earned from a wage earner or a clerical worker occupation, and at least one of the members has to be employed for 37 weeks or more in such an occupation. The CPI-W in 1982-84, its present base period, represented a little less than one-third of the U.S. population.

The more broadly based index, the CPI-U, reflects the expenditures reported by all consumer units in urban areas, and represented in the base period about 80 percent of the total U.S. population.

Currently, the differences in movement between the two indexes arise primarily from differences in expenditure patterns. The largest difference between the two indexes occurred from January of 1983 through December of 1984.

Prior to 1983, homeowners' costs in both indexes were based on an asset approach, which included the full investment in a house

as an asset and reflected the expenditures of only that portion of households which in the base year actually bought a house.

A flow of services concept reflected through rental equivalence data was introduced into the CPI-U in January of 1983. Because the CPI-W is used so extensively in collective bargaining negotiations, more time was required, more notice to the parties, to adjust to that change, and the new method was introduced in the CPI-W in January of 1985. As a result, we must exercise very great care in any comparisons of those two indexes between 1983 and 1985.

Since the CPI is a measure of the price change of a constant market basket of goods and services over time, the index is the Nation's primary barometer of inflation. CPIs also are used to deflate other economic statistics by adjusting them for price change, and to escalate income payments in a variety of public and private programs and contractual agreements. In fact, we are always hearing about new uses of the CPI in a variety of private contractual agreements, as well as public.

Since World War II, a great number of collective bargaining agreements have been written to provide increases in wage rates based on increases in the CPI.

As you have pointed out, Mr. Chairman, Social Security benefit adjustments were linked automatically to the CPI in July of 1972, or at least the legislation was enacted then. At the time that this legislation was passed, there was only one CPI, that for the wage and clerical worker population. It was not until January of 1978 that the CPI-U was developed.

Since the introduction of the CPI-U, it has been used to index many Federal programs—the food stamp program, section 8 housing, Pell grants, and in addition, of course, the income tax legislation.

Selection of an index to be used for a particular program requires an understanding of the population represented by that index and comparison of it to the targeted population.

I would like to review very briefly with you some of those characteristics.

One of every four U.S. households has at least one member receiving Social Security benefits. In the rural areas, nearly one in three households receive some benefits. Not all of the recipients are old. About 25 percent of all recipients are younger people, who receive benefits because of their disability, or because they are the surviving spouse or minor child of a worker. In addition, there are many older workers who might be eligible for Social Security benefits who prefer to continue working.

Neither of our CPIs cover rural areas. They are urban area related only, and both also exclude the institutional population. Nevertheless, 77 percent of the noninstitutionalized Social Security recipients live in units that are covered by the CPI-U, and only 7 percent live in units that are covered by the CPI-W.

It is not surprising. The CPI-W was designed to cover the urban wage earner and clerical worker population, whereas the CPI-U covers all urban consumers, regardless of their labor force participation, including the retired.

Census Bureau income statistics can show us that the median family income for families receiving Social Security benefits was a

little over $19,000, and that is a little less than the median income of all families of $26,500.

When we compare the incomes of Social Security recipients to those of the CPI-U and the CPI-W, we find that the income of Social Security recipients was lower than that of both index populations, but much closer to the CPI-U than to the CPI-W.

The CPI-W population has the highest median income, and that, again, is because, after all, employment and earnings are criteria for inclusion in the CPI-W.

Expenditure patterns are related to income, as well as to age and family size. Social Security recipients are older than the average population, and therefore, they devote a greater proportion of their budgets to medical care. Therefore, the expenditure for medical care for Social Security recipients is somewhat larger than in either of the two indexes that we have.

Social Security recipients devote a smaller share of their spending than the index population families do to apparel and upkeep, transportation, entertainment, and other goods and services.

Now, there is a chart attached to my testimony, and it shows quite clearly that when you look at the major group levels—food and beverages, housing, transportation, medical care in particular—you see clearly that the Social Security recipients' expenditures are closer to the CPI-U than they are to the CPI-W.

The two indexes have tended to move very closely with each other. There have been year-to-year fluctuations, and although that has happened over a longer period of time, Social Security COLAs based on the CPI-U would have been nearly the same as the official COLAs based upon the CPI-W. There is a table attached to my testimony, which shows that for a few years there were a tenth, more or less, and then a two-tenths and a three-tenths difference in 2 years. So the differences are extremely small.

Since 1985, when the CPI-W was converted to the same rental equivalence approach to home ownership as in the CPI-U, the differences have been extremely small. In 1986, the CPI-U exceeded the CPI-W by three-tenths of 1 percentage point, and in 1988, by one-tenth of 1 percentage point. The two indexes showed exactly the same rate of change in 1987.

We cannot predict for the future how these two indexes will behave. The expenditure patterns underlying the CPI-U and the CPI-W populations are different, and we do not know where inflationary shocks will originate.

For example, the steep price declines in energy in 1986 had a much more pronounced effect on the CPI-W than on the CPI-U, because energy has a higher weight in the CPI-W. If gasoline prices were to go up in the future, the CPI-W would be affected more than the CPI-U. If, on the other hand, medical care prices were to continue upward, since the weight in the CPI-U is a little bit higher, it would have more of an effect on that index.

I think that there is no conceptual reason to believe that the indexes would behave in a radically different manner than they have in the past.

So in summary, I think that we can say to you that Social Security recipients in urban areas are included in the expenditure experience of the CPI-U. They are excluded from the CPI-W, unless

they happen to live in a wage and clerical worker family. The CPI-U, therefore, includes a much larger proportion of the expenditure experience of Social Security recipients.

On average, the income of Social Security recipients is closer to the CPI-U than it is to the CPI-W, and the expenditure weights in the CPI-U are closer to the Social Security recipients' expenditure patterns than are the weights in the CPI-W.

We would be glad to try to answer any questions you have.

[The statement of Ms. Norwood follows:]

Statement of
Dr. Janet L. Norwood
Commissioner
Bureau of Labor Statistics
before the
Subcommittee on Social Security
Committee on Ways and Means
United States House of Representatives

April 26, 1989

Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to review with you some of the differences and uses of the two Consumer Price Indexes calculated and published by the Bureau of Labor Statistics. Since 1978, Consumer Price Indexes have been compiled monthly for the two population groups: Urban Wage Earners and Clerical Workers (CPI-W) and All Urban Consumers (CPI-U).

Definitions of the Two CPI's

The CPI-W is a continuation of the historical index which was initiated during World War I for use in wage negotiations. It is based on the expenditures of urban consumer units which meet additional requirements related to employment: more than one-half of the consumer unit's income had to be earned from clerical or wage occupations, and at least one of the members had to be employed for 37 weeks or more in such an occupation. The CPI-W population represented 32 percent of the U.S. population in the base period 1982-84.

The more broadly based index, the CPI-U, reflects the expenditures reported by all consumers in urban areas and represented 80 percent of the total U.S. population in 1982-84.

Currently, the difference in movement between the two indexes arise primarily from differences in the expenditure patterns of the two populations.

The largest difference between the two indexes occurred from January 1983 through December 1984. Prior to 1983, homeowners' costs in both indexes were measured by changes in prices of recently purchased homes, mortgage interest rates, property taxes, property insurance, and maintenance and repair costs. The former treatment was an "asset approach" which included the full investment in a house as an asset and reflected the expenditures of only that portion of households which purchased a house in the base year. A "flow of services" concept reflected through rental equivalence data was introduced in the CPI-U in January 1983. Because the CPI-W is used extensively in collective bargaining agreements, more time was required for parties to adjust to the change and the new method was introduced in the CPI-W in January 1985.

The change improved the index because it separated the shelter costs of consumers from the investment they made in owned homes. The new approach also reflected the shelter costs of all consumers represented by the index and is consistent with the underlying concept of the CPI as a measure of the changes in the prices of goods and services purchased for consumption.

Since the CPI is a measure of the price change of a constant market basket of goods and services over time, the index is the nation's primary barometer of inflation. The CPI's are also used to deflate other economic statistics (by adjusting them for price change) and to escalate income payments in a variety of public and private programs and contractual arrangements. Since World War II, a great number of collective bargaining agreements have been written to provide increases in wage rates based on increases in the CPI. Social Security benefit adjustments were linked automatically to the CPI as a result of legislation

enacted in July 1972. At the time this indexation was introduced, there was only one CPI -- that for the wage and clerical worker population. As I mentioned earlier, it was not until January 1978 that the CPI for all urban consumers was first calculated. Since the introduction of the CPI-U, it has been used to index many federal programs. Among these are the Food Stamp program, Section 8 Housing and Pell grants for higher education. In addition to these programs the Economic Recovery Tax Act of 1981 legislated the use of the CPI-U in indexation of tax brackets and other aspects of the IRS tax code.

Characteristics of Social Security Recipients

Selection of an index to be used for a specific program requires understanding of the population represented by the index and comparison of it to the targeted population. With that in mind, let us examine the demographic characteristics of Social Security recipients and compare them to the CPI-U and CPI-W populations.

One of every four U.S. households has at least one member receiving Social Security benefits.[1] In the rural areas, nearly one in three households receive some benefits. Not all of the recipients are old. About twenty five percent of all recipients are younger people who receive benefits because of disability or because they are the surviving spouse or the minor child of covered workers. Also, many older workers, otherwise eligible for Social Security benefits, forego them and continue working.

Neither of our CPI's cover rural areas and both also exclude the institutional population. Nevertheless, 77 percent of non-institutionalized Social Security recipients live in units covered by the CPI-U. In contrast, the CPI-W population includes only 7 percent of the non-institutionalized Social Security recipients. That is not surprising since the CPI-W was designed to cover the urban wage earner and clerical population. The CPI-U covers all urban consumers, regardless of labor force participation -- including the retired.

Income of Social Security Recipients

Census Bureau income statistics[2] show that the median income for families receiving Social Security benefits in 1984 was $19,307, somewhat less than the median income of all families of $26,491. Within the group receiving Social Security benefits, there is considerable income variability. Thirty seven percent of them had a total family income in excess of $30,000 and 9 percent had incomes greater than $50,000. At the lower end of the distribution scale, 18 percent had incomes that were less than $10,000.

For single persons, those receiving income from Social Security had a median total income of $7,251. The median income of all single persons was $11,448.

When we compare the incomes of Social Security recipients to those of the CPI-U and CPI-W populations, we find that the income of Social Security recipients was lower than that of both index populations, but closer to that of the U than the W. The CPI-W population has the highest median income, followed by the CPI-U and then the Social Security recipients. Again, this

---

[1] These households contain ninety six percent of Social Security recipients, an additional four percent of Social Security recipients are confined to nursing homes.

[2] 1984 was chosen for this comparison since it overlaps the CPI expenditure reference base.

result is not surprising since employment and earnings are criteria for inclusion in the CPI-W population.

Expenditure Patterns of Social Security Recipients

Expenditure patterns are related to income, age, and family size. Because many Social Security recipients are older than the average population, they devote a greater proportion of their budgets to medical care (about two-thirds more) than either of the CPI populations. Social Security recipients devote a smaller share of their spending than the index population families do to apparel and upkeep, transportation, entertainment, and other goods and services. While there are differences, as the chart attached to my testimony shows, in nearly all of the CPI major categories, the expenditure patterns of the Social Security recipients are more similar to those of the CPI-U population than to the CPI-W population.

To summarize, the inclusion of most Social Security recipients in the CPI-U index population and the nearly total exclusion of them from the CPI-W population results in the former's income and expenditure patterns being more like that of the Social Security recipients than the latter's.

The CPI-U and the CPI-W have tended to move very closely with each other. Although there have been year-to-year fluctuations, over a longer period of time, Social Security cost of living adjustments (COLA's) based on the CPI-U would have been nearly the same as the official COLA's based on the CPI-W (table 1). In the first 4 years that both indexes were available (1979-1982), the CPI-U was higher than the CPI-W once, lower once, and the same in the other 2 years. Comparisons were not computed for 1983-1985 since the two indexes measured homeownership costs differently and, as a result, are not directly comparable. However, since 1985 when the CPI-W was converted to the rental equivalence approach to homeownership, the differences have also been small. In 1986, the CPI-U exceeded the CPI-W by 0.3 percentage points and in 1988 by 0.1 percentage point. The two indexes showed the same rate in 1987.

Conclusion

In conclusion, we cannot predict how similarly the two indexes will behave in the future. The expenditure patterns underlying the CPI-U and the CPI-W populations are different, and we do not know where inflationary shocks will originate. For example, the steep price declines in energy items in 1986 had a more pronounced effect on the CPI-W than on the CPI-U since those items had a larger weight in the CPI-W. However, there is no conceptual reason to believe that the indexes would behave radically differently than they have in the past.

Mr. Chairman, I hope that my comments here today have provided useful insights into the differences and uses of the two Consumer Price Indexes.

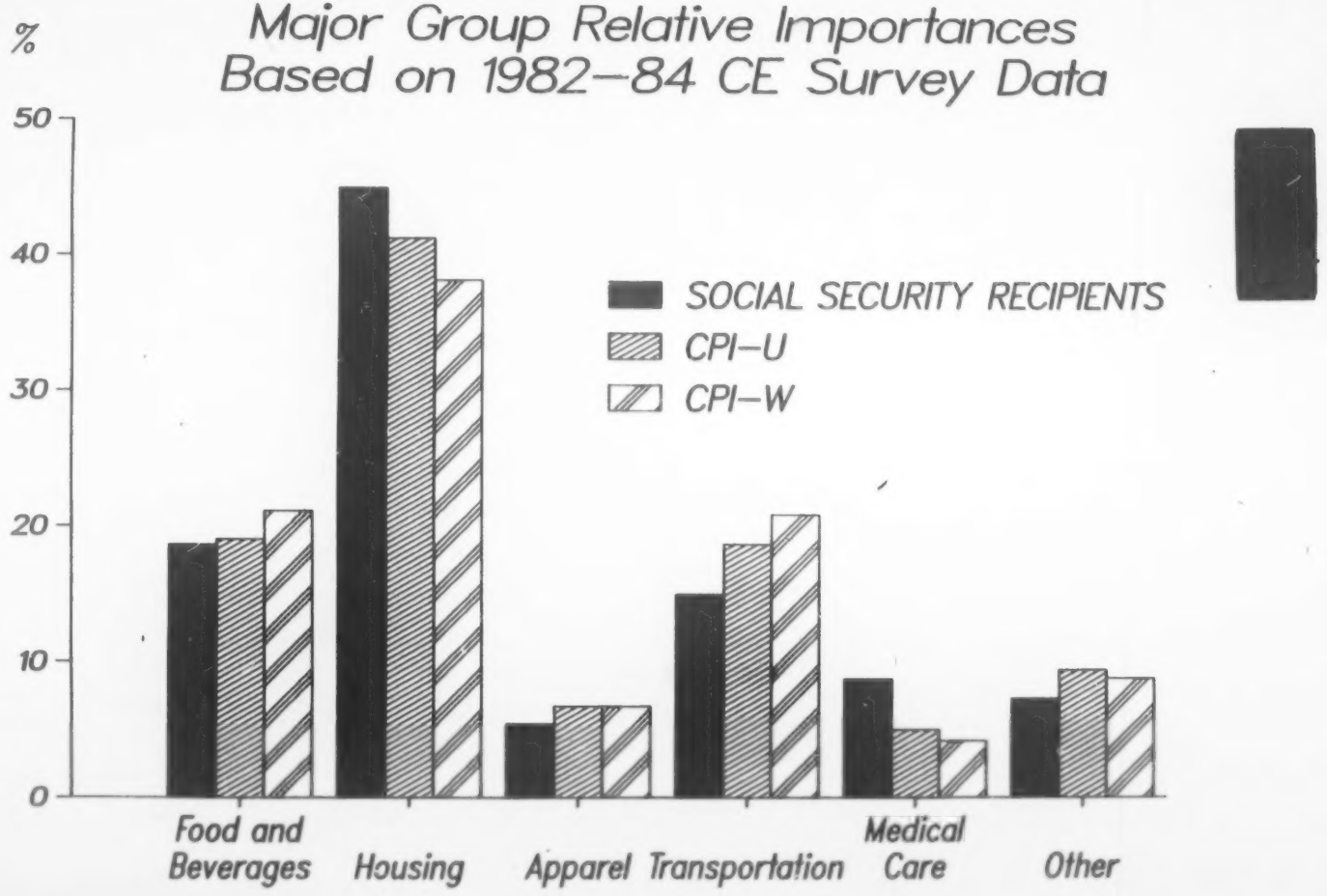
Table 1. Alternative Cost of Living Adjustments based on the CPI-U and the CPI-W, 1979-1982 and 1986-1988 (in percent)

Year	CPI-W	CPI-U	Difference
1979	9.9	9.8	-.1
1980	14.3	14.3	-
1981	11.2	11.2	-
1982	7.4	7.6	+.2
1986	1.3	1.6	+.3
1987	4.2	4.2	-
1988	4.0	4.1	+.1

Under the original provisions (based on the 1972a, 1973a, and 1973b Acts), the arithmetical mean of the CPI for January, February, and March in the year of determination was compared with the arithmetical mean of the CPI for the later of (a) January, February, and March of the year in which the last effective cost-of-living increase was established or (b) the 3 months of the calendar quarter in which the effective month of the last general benefit increase occurred. If the percentage increase in the CPI, rounded to the nearest one-tenth of 1 percent, was at least 3.0, a cost-of-living benefit increase was established and the level of benefits increased by the same percentage, effective for June of the year in which the determination was made.

The 1983 Act moved the effective date for the cost-of-living benefit increase from June to December, beginning in 1983. Effective with the determination made in 1984, the two periods used in calculating the CPI-W percentage increase were shifted from the first to the third calendar quarter.

99-506 O - 89 - 2


Major Group Relative Importances
Based on 1982–84 CE Survey Data
%
50
40
30
20
10
0
SOCIAL SECURITY RECIPIENTS
CPI–U
CPI–W
Food and Beverages
Housing
Apparel
Transportation
Medical Care
Other

Chairman JACOBS. Dr. Norwood, Mr. Brown and I are constrained by a requirement that we go over it, carefully read the journal from yesterday, make any necessary corrections, and certify that it is accurate, and that will take about 8 minutes. We will be right back.

Ms. NORWOOD. All right.

[Brief recess.]

Chairman JACOBS. Doctor, I think we will continue the hearing. Mr. Brown will be here presently.

Is there such a thing as the CPI-E, or is there such a thing as an embryonic CPI-E, or is there such a thing as a gleam in someone's eye that can be called the CPI-E—the "E" standing for elderly?

Ms. NORWOOD. There is, or was, an experiment that the Bureau of Labor Statistics carried out at the request of a congressional committee, which merely took the CPI database that is already collected and reweighted it with the weights of people—I believe that experiment was for those 62 years and older.

It showed that over some period there were slight differences. They were not terribly large, and of course, we have no assurance of what will happen over a longer period of time. There had been some studies that have showed that over the longterm, there may not be a lot of differences.

Our belief, however, is that in order to find out an answer to that, a good deal of research needs to be done. We believe that older people—people who are retired—probably buy different kinds of things. I am not sure they go out and buy designer jeans, for example. We know that they have more heart surgery, and certainly do not spend much money, if any, on child care.

So we feel that to measure price changes for older persons we would need to do some work. First of all, to expand the consumer expenditure survey, so that we would have more reliable data for this smaller group of the population, and then do some empirical research to see whether, in fact, they do buy different things.

The other point is that we know that they are concentrated in somewhat different areas of the country. The Northeast, for example, has more of them. People tend to be either in the very lovely places with a marvelous climate like Arizona, or else in some of the industrial cities where the younger people have left and the older people have remained.

So the area of data collection might well need to be different, as well as the item in the outlet samples, and then furthermore, there are a number of differences in pricing techniques. For example, senior citizens frequently have access to discounts, but their use is sometimes limited. On the subway, they can only use those discounted fares during certain parts of the day, and so on.

All those things would need to be taken into account, and that is a major job. It would cost a good bit of money and would take a considerable period time, and of course, we cannot assure you that if we did all that work, we would come up with an index that would be materially different from the existing indexes.

What we could assure you is that we have examined the issue, and we have an index that does properly represent those people.

Chairman JACOBS. Yes. My question was whether there was one in any form. You indicated——

Ms. NORWOOD. No.

Chairman JACOBS [continuing]. In the past-tense verb that there may have been the beginning of it. Is that correct?

Ms. NORWOOD. No. We did merely a reweighting, and we did it for a particular period of time, and we are no longer doing that.

Chairman JACOBS. Now, the urban Consumer Price Index, in terms of adjustment, has been somewhat more generous in recent years than the Consumer Price Index for the wage worker, the CPI-W. Correct?

Ms. NORWOOD. Yes, it has been slightly higher.

Chairman JACOBS. And am I correctly informed that the projections are that it is beginning to diminish in relation to the other, or is that just some newspaper reporter who is smarter than you are?

Ms. NORWOOD. First, let me say that we, quite happily, do not engage in forecasts of our own data. We prefer to wait and see what happens to them.

What I can tell you is that energy prices have been heating up, and that the weight for energy is somewhat higher in the CPI-W index than in the CPI-U. If that continues, clearly it will have a bigger affect and raise the CPI-W more.

On the other hand, you have to look at the other side, and that is that there is a difference in the medical care weight, and medical care prices have certainly been going up quite fast, and the CPI-U index has a higher weight for medical care.

Chairman JACOBS. Well, all we ask is a revelation.

Now, on the BRCM theory of Washington, it seems the trend is to index the benefits, which makes them keep pace with inflation, and, on the other side of the ledger, also to index the income tax, which tends to diminish it in terms of—BRCM means big rock candy mountain, but——[Laughter.]

Ms. NORWOOD. I was wondering.

Chairman JACOBS. Yes. So it is wonderful, because the people of the United States, although some think it is impossible, can have it both ways. Is that not essentially what this Government is doing, or to the public, ultimately now?

Ms. NORWOOD. Well, I would certainly not want to categorize the actions of the Congress in this field.

Chairman JACOBS. I do not mind. [Laughter.]

Ms. NORWOOD. I leave that to others.

It is true that our CPI's are being used more and more to escalate payments, and sometimes, one does worry a little bit about whether we are not perhaps serving almost as an engine of inflation. As you index wage payments, then the wage payments go up, and then people spend that money, and prices go up somewhat more.

Chairman JACOBS. But the other side of the ledger is that they are consciously going the opposite direction with the income. It is just built in that we will inevitably buy the formula adopted philosophically—increase the outgo and decrease the income, and it is well known that we are indexing the brackets, the income.

Ms. NORWOOD. Yeah. That is quite correct.

Chairman JACOBS. When you were creeping in the same direction, at least you were keeping sight of it, and this is not yet enor-

mous, but potentially an enormous contribution to a burgeoning deficit, if that word works anymore.

Ms. NORWOOD. Indexation certainly can contribute to a deficit, because it pushes costs up. The estimate——

Chairman JACOBS. I am trying to get you to say something about income.

Ms. NORWOOD. Well, let me just say that the estimate that we have been using that has been done by a number of people—it is not a BLS estimate—is that a 1 percent change in the CPI would trigger a fiscal effect of about $4½ billion, maybe a little more.

Chairman JACOBS. Yes, I am conversant with that, and many people are, but what about on the other side of the point. Have you analyzed the——

Ms. NORWOOD. Well, no, no. What I was going to say then is that a little more than half of that is in paying out more as indexation and Social Security benefits. Slightly less than half of that is in less income being taken in by the Federal Government——

Chairman JACOBS. So that we have an equation after all.

Ms. NORWOOD. So you do have it on both sides. You are quite correct.

Chairman JACOBS. Well, I guess I would have to say for the record that it is an age-old hope, that we can have our cake and eat it too. That hope does not diminish when you cross the beltway, I suppose.

If Mr. Brown has any omitted questions, may we submit them to you in writing?

Ms. NORWOOD. Certainly. We would be happy to give any help we can.

Chairman JACOBS. Thank you, Doctor, for your contribution.

Ms. NORWOOD. Thank you very much.

Chairman JACOBS. We are most grateful.

Mr. Ballantyne, the Chief Actuary for the Social Security Administration, is our next witness.

STATEMENT OF HARRY C. BALLANTYNE, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION

Mr. BALLANTYNE. Thank you, Mr. Chairman. I am pleased to be here today as the Chief Actuary of the Social Security Administration to discuss the Consumer Price Index, which is used to calculate the cost-of-living adjustments or COLA's under Social Security and the supplemental security income programs.

Before Congress enacted automatic COLA's in 1972, Social Security benefit increases were provided periodically by Congress on an ad hoc basis. Between January 1940 and June 1974, 10 of these ad hoc increases became effective. The CPI was not directly used to compute the amount of these adjustments as it is in the case of the automatic COLA's.

The provision for automatic COLA's was enacted into law in 1972. The law governing the mechanics of the COLA's has been amended a number of times since then, and the most recent time was in 1986, when the former 3 percent trigger requirement needed to generate a benefit increase was eliminated. However, the same

index, the CPI for urban wage earners and clerical workers, has been used for all the automatic COLA's.

In 1978, the Bureau of Labor Statistics revised the CPI by updating the market basket or the sample of items that are priced. In addition, a new index was introduced in 1978—the CPI for all urban consumers. The index for urban wage earners and clerical workers was labeled the CPI-W, and that covers about 32 percent of the U.S. population. The new index, for all urban consumers, was labeled the CPI-U, which covers about 80 percent of the U.S. population.

The Social Security Act does not explicitly say which of these two indexes should be used to adjust benefits. Rather, it simply refers to the CPI published by the Department of Labor.

When the COLA provisions were enacted in 1972, however, there was only one Consumer Price Index that could be used to adjust Social Security benefits, and that is the one that we now call the CPI-W. Since 1978, the revised CPI-W has been used for all the Social Security and the SSI COLA's.

The COLA increase is reflected in December Social Security benefits that are paid in January and is based on the increase in the CPI-W from the third quarter of the prior year through the third quarter of the current year. These increases are also reflected in the January payments under the supplemental security income program.

The COLA effective for the last December—December, 1988—was 4 percent and was based on the percentage increase in the CPI-W. If the 1988 Social Security COLA had been based on the CPI-U instead of the CPI-W, the benefit increase would have been 4.1 percent, and the average increase in benefits for retired workers would have been higher by about $6 per year. Also, total OASDI benefit payments would have been larger by an estimated $165 million in fiscal year 1989 and an estimated $220 million in calendar year 1989.

The COLA effective for December 1989, will be based on the percentage increase in the average CPI-W from the third quarter of 1988 through the third quarter of 1989, and that gets rounded to the nearest one-tenth of 1 percent.

In the 1989 trustees report, under the alternative intermediate II-B assumptions, we are assuming that the COLA for 1989 will be 4.8 percent. If the 1989 COLA were based on the CPI-U instead, it is likely that there would be no difference this year. Although, there could be a very small difference. It is too early to tell in which direction.

In the future, the CPI-W and the CPI-U will probably not increase at significantly different rates over any long period of time. If there is any difference, I would say it would be not possible to tell how much.

This concludes my prepared testimony, and I would be glad to answer any questions.

[An attachment to the statement follows:]

MEMORANDUM April 24, 1989

FROM: Harry C. Ballantyne S3N
Chief Actuary
Social Security Administration

SUBJECT: Selected Effects of Using the CPI-U for COLA's in 1983-88--INFORMATION

The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) has been used to determine the sizes of the cost-of-living adjustments (COLA's) in Social Security benefits since 1975. In 1975-77, the CPI-W was the only Consumer Price Index published by the Bureau of Labor Statistics (BLS). However, since January 1978, the BLS has also been publishing an additional index designated as the Consumer Price Index for All Urban Consumers (CPI-U).

If the COLA in each year 1983-88 had been determined by using the CPI-U, all but one of the COLA's in that period would have been higher than the actual COLA's based on the CPI-W, as shown in the following table:

Year	COLA based on-- CPI-W	CPI-U
1983	3.5%	3.6%
1984	3.5	4.2
1985	3.1	3.4
1986	1.3	1.6
1987	4.2	4.2
1988	4.0	4.1

For persons eligible for benefits before 1984, the benefits payable to them at the end of 1988 would be about 1.5 percent higher, if the CPI-U had been used for the COLA's in 1983-88.

For example, the illustrative monthly benefits payable to a hypothetical worker retiring at age 65 in January 1983, with steady earnings in each year 1940-82, would be affected as shown in the table below, for workers with various levels of earnings:

Level of earnings	Benefit for January 1983	Benefit for December 1988 COLA based on-- CPI-W	CPI-U	Difference
Low 1/	$368	$446	$453	$7
Average 2/	553	670	679	9
Maximum 3/	709	859	872	13

1/ Worker earned the minimum wage in each year.
2/ Worker earned the average wage in each year.
3/ Worker earned the maximum wage taxable and creditable toward Social Security benefits in each year.

The amount of OASDI benefit payments in each calendar year 1984 through 1989 would have been higher, by the estimated amounts shown below, if the CPI-U had been used for the COLA's in 1983-88:

Calendar year	Additional OASDI benefit payments (In billions)
1984	$0.2
1985	1.4
1986	2.0
1987	2.6
1988	2.6
1989	2.9

Harry C. Ballantyne

Harry C. Ballantyne

Chairman JACOBS. Mr. Brown will inquire.

Mr. BROWN. Thank you, Mr. Chairman.

Tell us, if you can, what difference there would be if you calculated the CPI, in this current year, on the 12-month basis as advocated by the AARP, rather than the third quarter basis? Is that significant in terms of cost?

Mr. BALLANTYNE. I would assume a 12-month basis would be from last September through this coming September. Again, it's too early to tell for this benefit increase—I think—which one may be higher. There have been differences in the past.

By taking an average for the quarter, you smooth out, somewhat, the variability in the increases. They don't fluctuate quite as much.

I've looked at the past several years to see what the increases would have been using September, and they sometimes are higher, and sometimes lower than the increases that we actually gave under present law. But, there is more variability. There are greater swings.

Mr. BROWN. With greater swings, is that not significant change?

Mr. BALLANTYNE. Not, overall. Over a long period of time the results should be nearly the same because the differences can't accumulate.

Mr. BROWN. In your mind is one system fairer than the other?

Mr. BALLANTYNE. Well, I don't know that one would be fairer than the other. You could say that the September—the 12-month could be a little more up-to-date, that would reflect the latest changes in the CPI.

On the other hand, because of the variability—the fluctuations—some people might get bigger COLA's than other people depending on when they are first eligible for benefits. That is compared to present law for these periods.

Mr. BROWN. Thank you. I yield back my time, Mr. Chairman.

Chairman JACOBS. I think that's sufficient Mr. Ballantyne. Thank you for your contribution to the record.

Mr. BALLANTYNE. Thank you.

Chairman JACOBS. Next witness is Frederick Ribe, who is Assistant Director for Fiscal Analysis of the Congressional Budget Office.

STATEMENT OF FREDERICK C. RIBE, ASSISTANT DIRECTOR FOR FISCAL ANALYSIS, CONGRESSIONAL BUDGET OFFICE, ACCOMPANIED BY ROBERT DENNIS, DEPUTY ASSISTANT DIRECTOR FOR FISCAL ANALYSIS, AND PAUL CULLINAN, ANALYST

Mr. RIBE. Thank you, Mr. Chairman.

I am happy to be here today. With me, on my left, is my colleague Robert Dennis, who is CBOs chief expert on the Consumer Price Index, among many other things. He is the Deputy Assistant Director for Fiscal Analysis. On my right is Paul Cullinan, who is CBO's chief expert on Social Security.

With your permission, Mr. Chairman, I would propose to submit my prepared statement for the record, and only to summarize it briefly in my remarks today. I think much of what CBO has to say has been covered by the witnesses that have spoken already. So, I would like to——

Chairman JACOBS. Not only with our permission, but with our deep gratitude.

Mr. RIBE. Thank you.

We would make three broad points, which are consistent with those that have been made by the witnesses already.

First, although the CPI-U is a much broader index of the price level than is the CPI-W, there has been little difference in their behavior in the past—much as Dr. Norwood pointed out.

Second, just as the previous two witnesses have said, is that there is likely to be little difference in the future. Or, to put it differently, we are unable to predict any systematic difference in the future.

Third, there are, nevertheless, technical arguments that appear to support the use of the CPI-U for indexation of Social Security benefits.

Although there may well be nontechnical arguments, for not using the CPI-U, some of which are alluded to in my statement, our contribution today is simply to go through the arguments for and against, as we see them.

CBO is not, however, taking a position either way on the adoption of the CPI-U as an index for Social Security.

I would return briefly to the first point I made—that there has been little difference between the CPI-U and the CPI-W in the past. As Dr. Norwood pointed out, changes between the two have averaged about 0.2 percentage point in the past. This seems to be true even when one takes into account the definitional changes in the two indexes that have happened during the early 1980s. Our prepared statement shows some detail on that point.

Let me also add that, to the extent that there are slight differences, there are reasons, alluded to in our prepared statement, to discount them as being statistically significant indicators of a difference in the cost of living faced by the two populations covered by two indexes.

For statistical purposes, then there is really no difference observable in the past.

The second point is, as the other two witnesses have pointed out, that we are not in a position to forecast that the two indexes will behave differently in the future. But there is a chance that the CPI-U will rise a little bit less quickly during fiscal year 1989—the reference period that will be used for indexation of benefits in December 1989 or January 1990.

Therefore, if by any chance, there were to be a switch from the CPI-W to the CPI-U, effective with the next indexation in late 1989 or early 1990, there is a chance that there will be a slightly lower cost-of-living (COLA) under the CPI-U than there would be under the CPI-W.

Although CBO is in the economic forecasting business, we have not updated our current forecast and therefore are not in a position to say this with any great confidence. We just based this statement on the fact that as of early 1989, energy prices have risen faster than prices in general. As a result, as Dr. Norwood's comments suggest, there might be a higher increase in the CPI-W during the first 9 months of this year, than in the CPI-U.

I would like to touch briefly on the technical arguments for and against adoption of the CPI–U, as we see them. We elaborate some on the testimony that has been presented for the record.

Because the CPI–U is a broader index of the price level, as previous witnesses have pointed out, it appears to be preferable, on technical grounds, as a Social Security index for two reasons.

First, it is much more widely used as a measure of the price level by the general community. And, as such, there is likely to be less confusion about inflation if it is also used in the Social Security context.

Second, the CPI–U better serves both of the possible objectives that the Congress may have in indexing Social Security to the price level. One is to protect Social Security beneficiaries for inflation faced by the general population, and the other is to protect them for inflation that they experience themselves. In either case, the CPI–U appears to be a better index, precisely because it is more broadly based. As I said, there may well be nontechnical arguments against the adoption of the CPI–U, which are alluded to in our statement. We at CBO do not wish to take a position on the issue of which index to adopt. But we nevertheless wanted to go through the arguments, for and against, as we see them.

Thank you, Mr. Chairman.

[The statement of Frederick Ribe follows:]

Statement of
Frederick C. Ribe
Assistant Director for Fiscal Analysis
Congressional Budget Office

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to discuss the price index used to calculate cost-of-living adjustments (COLAs) for Social Security. My remarks will focus on the economic arguments for and against using the CPI-U (the Consumer Price Index for all urban consumers) instead of the CPI-W (the index for urban wage earners and clerical workers), as well as the potential budgetary consequences of such a change.

BACKGROUND ON THE CPI-U AND CPI-W

Cost-of-living adjustments in the Social Security system are currently linked to growth in the CPI-W. The CPI-W is a measure of what it would cost now to buy a fixed basket of goods and services. The basket reflects the estimated spending patterns of wage earners and clerical workers in urban areas according to a survey conducted between 1982 and 1984.

Many economists have advocated using instead the CPI-U because it is a much broader and more commonly used index of inflation. Like the CPI-W, the CPI-U is based on estimated spending patterns during the 1982-1984 period, but its sample population comprises all urban consumers rather than just wage earners and clerical workers. Urban consumers account for 80 percent of the nation's population, while wage earners and clerical workers in urban areas account for only 32 percent.

Differences Between the CPI-U and the CPI-W

Patterns of expenditure reflected in the CPI-U differ from those in the CPI-W in three main areas: food, housing, and transportation. All urban consumers--the group whose consumption patterns underlie the CPI-U--spend a smaller proportion of their total budget on food and transportation, and more on owner-occupied housing, than do urban wage earners and clerical workers. The "all urban" group also spends more on medical care, though the difference is less pronounced.

The CPI-U has grown slightly faster than the CPI-W since the former measure was introduced in 1978. The CPI-U has increased 95.7 percent over this period, while the CPI-W has risen 92.4 percent--a difference that averages less than 0.2 percent per year. Differences in the treatment of homeownership costs, changes in energy prices, and a relatively fast increase in medical care costs account for most of this small difference.

Making inferences from past behavior of the two CPIs is complicated, however, by the fact that the treatment of homeownership costs was changed in both indexes during the early 1980s. But focusing on data since 1984, when homeownership costs were treated more consistently, does not change the story of slightly faster growth in the CPI-U: it has risen 16.1 percent since December 1984, while the CPI-W has increased 15.2 percent--again representing a difference of about 0.2 percent a year. A similar conclusion results from estimating how the indexes would have grown since 1978 if the current treatment of homeownership had been applied to both indexes throughout that period. CBO estimates on this basis that the CPI-W would have risen 94.1 percent, almost the same as the CPI-U's 95.7 percent increase.

Although the changes in the two indexes have sometimes showed significant differences from year to year, these differences have on balance averaged out. In 1986, for example, the CPI-W rose much more slowly than the CPI-U because gasoline prices fell sharply. The two indexes moved closer in the following year, however, when gasoline prices changed by less.

Significance of Differences Between the CPI-U and the CPI-W

While the CPI-U has increased slightly faster in the recent past than the CPI-W, this difference does not necessarily mean that the cost of living has increased by more for the "all urban" population reflected in the CPI-U compared with the price increases recorded in the CPI-W. Two reasons account for this: errors may occur in the measurement of prices in both indexes, and the true cost of living may not grow by the same amount as an error-free price index does.

The possibility of errors in the measurement of price changes means that even when the CPI-U and the CPI-W increase by different amounts, they may not reveal anything significantly different about how prices are changing. Errors in the indexes arise both from sampling error and from other sources. The Bureau of Labor Statistics (BLS) obviously cannot collect all the prices of all the goods and services for sale in every store in the land, so it uses a sample designed to be as representative as possible. Because the sample is not perfectly representative, however, some error is introduced. Other sources of error, which the BLS believes are substantially more important, arise from problems such as changes in product quality, the introduction of new products, and the technical problems of survey design.

Even if one could remove all error from the CPI-U and the CPI-W, neither index would necessarily give a true picture of changes in the cost of living. These indexes measure nothing more than price changes; they do not reflect changes in buying patterns, which can offset the cost to consumers from increases in prices. In fact, when faced with an unusually high price for any one item, most consumers will try to purchase less of it. If gasoline costs $2 per gallon, people first drive less, and then, when they next buy a car, pay more attention to its fuel efficiency. When beef prices rise, people switch temporarily or permanently to chicken. Recent studies suggest that, overall, changes in purchasing patterns hold down cost-of-living increases by about 0.1 percent to 0.2 percent a year relative to the increases recorded by consumer price indexes. This is an average figure, and does not reflect the fact that consumers differ in their ability to substitute cheap items for expensive ones.

BUDGETARY IMPLICATIONS OF SWITCHING TO THE CPI-U

Switching to the CPI-U as a Social Security index may well affect budget outlays, but analysts could not predict with confidence whether it would increase or reduce outlays unless the change were made quite soon. Social Security benefits would have been higher if the CPI-U had been used as an index since 1978, because the CPI-U has grown slightly faster than the CPI-W during that period. This increase does not mean, however, that switching to the CPI-U will necessarily cost more in the future. The prices of the specific categories of commodities and services whose recent changes accounted for the CPI-U's more rapid growth may not behave in the future as they have in the past. Such specific prices, like the price of energy, are notoriously hard

to predict, and, as a result, CBO and other forecasters seldom project differences in the growth rates of the CPI-U and CPI-W. Accordingly, if CBO were asked to estimate the cost of switching to the CPI-U beginning in fiscal year 1991 or later, it would project a budgetary impact of zero.

If, however, a proposal were made to switch to the CPI-U effective in fiscal year 1990, then CBO might project a budgetary impact, since the projection would be based in part on price changes that have already taken place. Currently, Social Security COLAs take effect in January and are based on price changes that occurred over a reference period covering the year ending in the third quarter of the previous calendar year. CBO could project a budgetary impact, however, if a change in the COLA were proposed to take effect soon enough so that the likely price change over the reference period would be either already known or heavily affected by price developments that are already known. At present, for example, gasoline prices are rising much faster than other prices, which suggests that by the time CBO updates its forecast of prices and other economic variables this summer, the CPI-U may have grown less than the CPI-W. If we project no further differences between the growth rates of the CPI-U and CPI-W for the remaining months of the reference period, the projected Social Security COLA for next January would be somewhat lower if it were based on the CPI-U rather than on the CPI-W.

ARGUMENTS FOR AND AGAINST USING THE CPI-U INSTEAD OF THE CPI-W

Shifting to the CPI-U as an index for Social Security benefits has both advantages and disadvantages. One advantage is that the change in the CPI-U is the measure of inflation now most frequently quoted in the press and by economists. Use of a different measure for calculating COLAs risks confusing the discussion of budget projections and economic forecasts.

A second advantage of a shift to the CPI-U is that it may better serve two objectives that policymakers may have in indexing Social Security benefits for inflation. First, if the objective of indexing is to protect Social Security beneficiaries from declines in their standard of living caused by inflation, the CPI-U may be a better choice because it appears to reflect more accurately the prices faced by beneficiaries. Second, if the purpose of indexing is to compensate Social Security beneficiaries for the inflation faced by the general population, then the CPI-U is still a better index than the CPI-W--again because it is a more general price measure.

The disadvantages of switching to the CPI-U primarily have to do with how some Social Security beneficiaries may perceive such a change. Some beneficiaries may be bothered by a shift to a different index. Indeed, in these times of budgetary pressures, they may interpret any change in Social Security as a cost-saving measure, notwithstanding the government's assurances to the contrary.

CONCLUSION

The CPI-U has increased faster than the CPI-W by about 0.2 percent a year in the recent past. This difference is not large enough to permit us to say

with confidence that the cost of living has increased faster for members of the "all urban" population, whose spending patterns are reflected in the CPI-U than for the population of wage earners and clerical workers in urban areas, whose spending underlies the CPI-W. We can say, however, that Social Security benefits would be higher had they been indexed to the CPI-U instead of the CPI-W in the past. Still, there is no basis for believing that a switch to the CPI-U would increase benefit levels in the future unless the change were made very soon. A decision to make such a change should bear in mind that the beneficiaries may misinterpret the change as a money-saving measure, but that the CPI-U, being a broader index, has certain technical advantages over the CPI-W.

Chairman JACOBS. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Your comment about inflation, that the recipients themselves face, I think is very important.

If you were trying to get a good measure of what the senior population faces, in terms of cost increases, would you go with one of these two indexes? Or would you try and create a new one?

Mr. RIBE. I think Dr. Norwood's comments were right on target. Although we cannot say so for sure, it seems very likely the CPI-U is a better index than the CPI-W for the elderly—for the recipient population.

We could do better, but the BLS has not yet done the very considerable amount of research, which Dr. Norwood mentioned, that would be required to do an adequate job in constructing an index for the elderly.

Mr. BROWN. Would it be your judgment that the elderly have significantly different spending patterns than the balance of the population? That perhaps gasoline and interest rates should be smaller factors, and health care costs, for example, should be a larger one?

Mr. RIBE. We want to be a little careful with that statement. I think an untutored intuition suggests yes. However, we point out that the elderly are a varied group. We have what we call the old old, and the young old. There is evidence that the expenditure patterns are quite different among those subgroups of the elderly. We also point out that 25 percent of the beneficiary population of Social Security is younger than 62.

We would share Dr. Norwood's caution that there is a good bit more work to be done before going forward with this sort of approach.

Mr. BROWN. You don't want to make a blanket statement just yet? Whether they're being treated fairly?

Mr. RIBE. As far as we can tell, the variation among expenditure patterns of subgroups of the elderly is large relative to the variation between the elderly as a whole, and the general population. The variable among subgroups of the elderly is not just a second matter, or a matter of minutia. As a result it is very hard to make priori judgments that turn out to be accurate on the issue.

Mr. BROWN. You should know I appreciate your comments, and I intend to use them myself sometime when I'm not anxious to express similar judgments—which should be more often.

Chairman JACOBS. I couldn't help being curious that there's subgroup for people like Hume Cronyn and Don Ameche in Cocoon. Have you contemplated that at all? [Laughter.]

How's your Consumer Price Index, do you get out to the movies.

Counsel has a question.

Ms. WISE. I'd like to ask you some questions about costs—if, in fact, one index rose faster than the other.

If, in fact, the Social Security program were using the CPI-U, and the CPI-U were to rise faster than the W by—let me give you two hypotheticals—a one-tenth of 1 percent a year higher for 5 years, and a two-tenths of 1 percent higher for 5 years. Can you tell me what the 5-year costs would be in each instance?

Mr. RIBE. We have those figures for 1 year. Sorry, I am seeing this too for the first time. I will ask Mr. Cullinan to give you this information.

Mr. CULLINAN. The numbers you have requested basically increase over time. I do not have a 5-year total here. But, if the CPI-U were to run at a tenth of a percentage point above the CPI-W, and begin that with the next benefit increase, we would see an increase in Social Security spending of about $180 million during the next fiscal year. That annual amount would rise to about $1.3 billion by 1994.

The other amount you requested was 0.2, or 0.5?

Ms. WISE. Point 2.

Mr. CULLINAN. Point 2. Basically, we are talking about doubling the costs of a 0.1 percentage point increase. By 1994 we would be seeing the annual outgo of the Social Security program increase by about $2.6 billion in that year.

Ms. WISE. That's a 1 year——

Mr. CULLINAN. That would be the 1 year.

Ms. WISE. 1994 only?

Mr. CULLINAN. That is right, and obviously it would be somewhat less in earlier years. Potentially somewhat more after that, depending upon what the different indexes did after that time.

Ms. WISE. Does that include SSI, or is that only——

Mr. CULLINAN. That is only Social Security.

Ms. WISE. Could one reverse those numbers and them savings, I guess, if——

Mr. CULLINAN. It is a symmetric argument. That is right—at least within this range.

Ms. WISE. Thank you.

Chairman JACOBS. Do the objective thinkers at CBO have an opinion about the question I propounded to the doctor from the Bureau of Labor Statistics—about the two-way stretch on indexing that's become a trend in the U.S. Government?

Mr. RIBE. We have figures showing that the indexation of income tax brackets and other features of the income tax has, of course, increased the deficit, under certain assumptions, while holding other matters constant. Your intuition is right—there is very little doubt about that. The same is true with indexation of benefits. Whether the increased deficit has itself fed inflation, as Dr. Norwood suggests, is——

Chairman JACOBS. That was not my question.

Mr. RIBE. OK.

Chairman JACOBS. That was what we call obiterdictum, I think, in response to the question.

Thank you, very much, for your contribution to the record.

Our next witness, with a large hunk of American history, the honorable Arthur Flemming, cochair of the Save Our Security Coalition, Secretary of Health and Human Service under General Eisenhower—President Eisenhower. And, also, most people don't know this, a member of the National Security Council in the Administration of Dwight Eisenhower. We are not only pleased, but honored, to have you Dr. Flemming.

STATEMENT OF ARTHUR S. FLEMMING, CHAIRMAN, SAVE OUR SECURITY COALITION

Mr. FLEMMING. Thank you, Mr. Chairman.

I deeply appreciate the opportunity of appearing before the subcommittee, in order to discuss the Consumer Price Index used to calculate cost-of-living adjustments, and Social Security benefits. I'm very happy that this committee is addressing this particular issue.

Older persons have expressed their concern to me regarding this issue—from the time I began serving as U.S. Commissioner on Aging, right down to the present time.

Like many of those who have talked to me over a period of years, I'm not a professional statistician. Like them, however, I've felt that the index which has been, and is being used, does not reflect as accurately as it should the experiences that many Social Security beneficiaries—old and young—are having as consumers.

I've had the opportunity of being well-acquainted with the work of the Bureau of Labor Statistics over a period of 50 years. I have the highest regard for the high standards of performance that Commissioners of Labor Statistics have set, and maintained, over this span of time. I feel that we're deeply indebted to them, and to their associates, for the services they have rendered.

I've read the testimony of Commissioner Norwood, as presented to the Special Committee on Aging of the U.S. Senate, on October 5, 1988. I've noted, especially, this conclusion—in nearly all of the major CPI categories the expenditures of the Social Security recipients are closer to the CPI–U than to the CPI–W.

I listened to Commissioner Norwood's testimony here this morning, and, of course, it is consistent with the testimony she gave earlier.

I believe that this conclusion should lead to a decision to shift from a cost-of-living index which measures the cost of living of urban wage earners, and clerical workers—the CPI–W, to one that measures the cost of living of all urban consumers—the CPI–U.

I recognize that the Bureau of Labor Statistics has reweighted the Consumer Price Index from January 1983 to March 1988, to reflect the expenditure experience of older Americans. Over this 5-year period, the experimental index rose to 19.5 percent—as compared with 18.2 for the CPI–U, and 16.5 for the CPI–W.

However, the experimental index gave no consideration to the 25 percent of Social Security beneficiaries who are below the age of 62. Other limitations of the reweighting experiment that are identified by Commissioner Norwood, in her testimony, make it clear that the reweighted experiment should not be implemented until it is expanded to include all Social Security beneficiaries, and subjected to more closer scrutiny than has been the case up to now.

Personally, I believe that we should not wait for further study of the experimental index for older persons, to put into effect a shift from the CPI–W to the CPI–U for Social Security beneficiaries—a shift which would bring into the picture a market basket that would reflect expenditures much more in line with the actual expenditures of Social Security beneficiaries.

If we make the shift from CPI–W to CPI–U, we will be making a contribution to a feeling of increased confidence in the administration of the Social Security system.

That feeling of increased confidence will be based on the realization that the population being surveyed, to arrive at the cost-of-living index, includes 77 percent of the noninstitutionalized Social Security beneficiaries, as contrasted with only 7 percent of noninstitutionalized Social Security beneficiaries included in the CPI–W.

Thank you, very much, Mr. Chairman.

[The statement of Arthur S. Flemming follows:]

OUTLINE OF TESTIMONY

BY

ARTHUR S. FLEMMING
Chairman, Save Our Security Coalition

I. Introduction

A. I appreciate the opportunity of appearing before the Subcommittee on Social Security of the Committee on Ways and Means to discuss the consumer price index used to calculate cost-of-living adjustments in Social Security benefits.

B. I am delighted that this Committee has decided to address this issue at this time.

II. Body

A. Older persons have expressed their concern to me regarding this issue from the time I began serving as U. S. Commissioner on Aging right down to the present.

1. Like many of those who have talked to me over a period of years I am not a professional statistician.

2. Like them, however, I have felt that the index which has been and is being used, does not reflect as accurately as it should the experiences that many Social Security beneficiaries--old snd young--are having as consumers.

3. I have been especially concerned about whether or not it reflects accurately our experiences in the areas of housing and health care.

B. In light of the major role that the index now being used plays in determining the income of Social Security beneficiaries, I believe it is important to confront head-on the perception on the part of many of these beneficiaries that the index leads to their being treated unfairly in connection with Social Security Cost of Living Adjustments.

1. Unless the issue is confronted and resolved in a manner consistent with the actual experiences that Social Security beneficiaries have as consumers, it will continue to be a festering sore contributing to an undermining of faith in the ability of our government to be fair.

C. I have had the opportunity of being well acquainted with the work of the Bureau of Labor Statistics over a period of fifty years.

1. I have the highest regard for the high standards of performances that Commissioners of Labor Statistics have set and maintained over this span of time.

2. Our nation is deeply indebted to them and to their associates for the services they have rendered.

3. I have read the testimony of Commissioner Norwood as presented to the Special Committee on Aging of the United States Senate on October 5, 1988 and have noted especially this conclusion:

"... in nearly all of the major CPI major categories, the expenditures of the Social Security recipients are closer to the CPI-U than to the CPI-W."

D. I believe that this conclusion should lead to a decision to shift from a cost-of-living index which measures the cost-of-living of urban wage earners and clerical workers (CPI-W) to one that measures the cost-of-living of all urban consumers (CPI-U).

(a) I recognize that the Bureau of Labor Statistics has re-weighted the Consumer Price Index from January 1983 through March 1988 to reflect the expenditure experiences of older Americans.

(1) Over this five-year period the experimental index rose to 19.5% as compared with 18.2% for the CPI-U and 16.5% for the CPI-W.

(2) However, the experimental index gave no consideration to the 25 percent of Social Security beneficiaries who are below the age of 62.

(3) Other limitations of the reweighting experiment that are identified by Commissioner Norwood in her testimony make it clear that the reweighted experiment should not be implemented until it is expanded to include all Social Security beneficiaries and subjected to much closer scrutiny than has been the case up to now.

(b) We should not wait for further study of the experimental index for older persons to put into effect a shift from the CPI-W to the CPI-U for Social Security beneficiaries--a shift which would bring into the picture a market basket that would reflect expenditures much more in line with the expenditures of Social Security beneficiaries.

III. Conclusion

A. If we make the shift from CPI-W to CPI-U we will be making a contribution to a feeling of increased confidence in the administration of the Social Security System.

B. That feeling of increased confidence will be based on the realization that the population being surveyed to arrive at the cost of living index includes 77% of the Social Security beneficiaries

Chairman JACOBS. Mr. Brown will inquire.

Mr. BROWN. Mr. Secretary it's an honor to have you here.

Tell me, do you believe there would be any significant difference between these indexes in the future?

Mr. FLEMMING. Well, I rely, in response to that question, on the testimony given by Commissioner Norwood. Judging from that testimony, apparently there would not be—certainly over the next few years anyhow—any considerable difference.

I feel that if the shift is made, that the perception of how it is being arrived at, on the part of Social Security beneficiaries, will be a much better perception than they now have of how it is being arrived at. I think it would be a real gain.

I know, beginning back in the early 1970's, when I was out meeting with older persons, I'd very often get the question. That was right at the beginning, of course, of the cost-of-living adjustment. I would get the question from them: why is it that our spending experiences are not considered when it comes to developing this index? A little bit hard to respond to.

It seems to me that the CPI-U is a very adequate response to that question. I like it from that point of view. I think people would have more confidence in the way in which we arrive at the determination. But, apparently, it would not make a great deal of difference.

Some years it might be up a little, other years it might be down a little—as compared to the CPI funding. The spending habits—practices—of the Social Security beneficiaries would enter into the determination.

Mr. BROWN. Do you think it would be worth trying to develop a separate index, that is much more attuned to measuring the cost of living increase for senior citizens—above and beyond the CPI-U?

Mr. FLEMMING. I have followed, with interest, the experimental index that BLS did develop on older persons.

I've listened to, and read, Commissioner Norwood's testimony on that before the Senate committee. Then when I read that as over against the testimony on the CPI-U, in my own mind, I wonder whether or not the CPI-U does not cover the situation adequately.

Certainly, I don't think we could answer the question that you just posed without further indepth work on the part of the Bureau of Labor Statistics.

Mr. BROWN. Thank you.

Chairman JACOBS. Dr. Flemming, I don't suppose we should delve too deeply into something the Bureau of Labor Statistics, and the Congressional Budget Office, declines to examine, but I suppose the less informed you are, the brighter you tend to be—and more certain.

It occurs to me that on the question of the special index for retired people, there are some obvious factors.

One, no bus fare to work usually. The other—on the other side of the coin—would be enormous medical costs. But, on the other side of that side of the coin, I suppose would be the part that's already covered as a right, or an entitlement, under the Medicare program.

I suppose you'd just turn up a welter of confusion, as the good doctor from the Bureau of Labor Statistics indicates, if you tried that. I assume from your testimony you would concur with that.

Mr. FLEMMING. I do. I am very much inclined to concur with the—I guess we wouldn't refer to them as conclusions on the part of Commissioner Norwood, but her observations are based on the work that they did on the experimental reweighting.

She points out that, if we're going to rely on anything of that kind, it would require indepth work on the part of the Bureau, which would take into consideration the factors that you've identified.

Chairman JACOBS. I suppose it always has to be rough justice. We are individuals. Some of us are prone toward greater spending habits than others.

Some children have to have cushions every day. Others, maybe in the State Mr. Brown's from, find joy in what nature already provides, the rocks and the sticks of the forests.

Mr. BROWN. I thought you were referring to the opposite sex—nature. [Laughter.]

Chairman JACOBS. I don't think——

Mr. BROWN. Perhaps in Indiana it's different. [Laughter.]

Chairman JACOBS [continuing]. The opposite sex gets distinguished from nature. As I've read, that's part of it. [Laughter.]

Mr. BROWN. There may be some regional differences.

Chairman JACOBS. I hope not.

You always find what President Reagan used to call episodic situations. Where as one old farmer in Kansas said: "It's not the high cost of living, it's the cost of living high." It's always going to be a relative matter.

Some people like to consider it a matter of routine to go off to Hawaii periodically. I've also read it's enormously expensive.

Mr. BROWN. Mr. Chairman, not to be argumentative, but I don't recall that President Reagan used language like episodic.

Chairman JACOBS. Well, maybe he read it. I don't know. [Laughter.]

It came from his mouth on a couple of occasions I recall.

But, in any case, the point is that anytime you deal with an enormous, and colossal, gathering of people in a civilization ruled by law—sadly, but inevitably—there will be rough justice.

You will not always serve each individual in what we would call a fair or just basis, but I don't know what in the world you can do. Another President said life is very unfair—Mr. Kennedy, I think in this case it was.

Mr. FLEMMING. Right. That's why I feel that the CPI–U, including as it does 77 percent of the noninstitutionalized Social Security beneficiaries, as contrasted with the CPI–W, which includes only 7 percent, certainly is very responsive to the basic issue of being fair and just.

If we shift to that—it's there, and we can shift to it very easily. If we shift to that, none of the Social Security beneficiaries—both old and young—will have more confidence in the way in which the cost of living index is developed.

Chairman JACOBS. Well, let's face it perfection is not the province of human effort. Mr. Cellers, my former chairman from New York, said that even a diamond has its flaws.

So, we try to do our best, and doing our best will always include the possibility of doing better. That's what this is all about.

Mr. FLEMMING. That's right.

Chairman JACOBS. We thank you Doctor.

Mr. FLEMMING. You're welcome, and it's a pleasure to appear before you.

Chairman JACOBS. Our final witness is George Zimmerman for the American Association of Retired People, AARP. He represents that organization, and is a member of the Michigan State legislative committee.

We're pleased to have you, Mr. Zimmerman.

STATEMENT OF GEORGE ZIMMERMAN, MEMBER, MICHIGAN STATE LEGISLATIVE COMMITTEE, AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. ZIMMERMAN. Thank you. Good morning, Mr. Chairman, and Congressmen.

As indicated, my name is George Zimmerman. I'm a member of the State Legislative Committee of the American Association of Retired Persons for the State of Michigan.

The association, which represents the interests of Americans aged 50 and above, appreciates the opportunity to testify on the use of the Consumer Price Index for all urban consumers—CPI-U—in the determination of cost-of-living adjustments.

AARP has had a long standing interest in using the most accurate index for COLA's. Ever since the automatic COLA's were begun, the association has been concerned that COLA's are based upon the spending patterns that do not reflect those of Social Security beneficiaries.

AARP believes that the CPI-U meets the accuracy criteria, and is a better measure of inflation for older persons, than the currently used Consumer Price Index for wage earners and clerical workers—the CPI-W—for several reasons.

One, the CPI-U is broader based than the CPI-W. And, it more closely approximates the experimental price index for older Americans developed last year by the Bureau of Labor Statistics (BLS). Therefore, the association makes two specific recommendations to the subcommittee.

First, that all Federal agencies use CPI-U for all cost of living adjustments.

Second, that the BLS redefine and recalculate the medical care component of the Consumer Price Index to more accurately reflect price movements and the true costs of medical goods and services.

In June 1988, BLS released the results of a study of an experimental index that measures the rates of inflation affecting Americans 62 years and older. The results confirm the widely held opinion that CPI-U is the more appropriate measure of the inflation of this population. BLS concluded that the expenditures of older Americans more closely resemble the CPI-U than the CPI-W.

An accurate CPI is essential for the elderly who are more affected by changes in the CPI than any other population group. However, all individuals who are dependent upon income from Government benefits and allowances, are very concerned about a gradual erosion of their purchasing power.

If the CPI does not accurately reflect price movements of items they purchase, the recipients may find it is difficult to maintain their level of living.

On the other hand, if the opposite occurs, and their benefits are indexed to a CPI that overstates the changes in the prices of items purchased, their economic well-being improves at a high cost to the taxpayers. Therefore, it is in everyone's best interest to use the most accurate CPI for COLA's.

In addition to an overall concern with the indices used for COLAs, AARP asks the subcommittee to request that the BLS analyze the manner in which the medical care component is defined.

Currently, medical care in the CPI reflects only out-of-pocket expenses for health related commodities and services. This may have been appropriate several years ago, before the widespread use of employer paid health insurance plans, Government supported health insurance programs—Medicare and Medicaid—and the wide availability of health maintenance organizations.

These expenditures are not reflected in either CPI, and therefore, the indices do not record all the costs of medical care used in the United States.

Prior to any implementation of a CPI-U, the Social Security Administration, the Office of Management and Budget, and the Congressional Budget Office, should provide impact analysis reports to the appropriate Congressional committees on the use of the CPI-U for COLA calculations.

Our association appreciates this opportunity to testify. I would be glad to answer any questions you might have. The written testimony will be submitted for the record.

[The statement of George Zimmerman follows:]

STATEMENT

of the

AMERICAN ASSOCIATION OF RETIRED PERSONS

The American Association of Retired Persons (AARP), a membership organization representing the interests of persons aged 50 and older, is pleased to testify today on the use of the Consumer Price Index for All Urban Consumers (CPI-U) in the determination of cost-of-living adjustments (COLAs) to government benefits and allowances. We commend the committee for its interest in ensuring that COLAs are computed using the most accurate measure of inflation.

AARP specifically recommends:

- That all federal agencies use the CPI-U for all cost-of-living adjustments. Prior to implementation, an impact analysis of the change on the trust funds and federal outlays should be done. Implementation would need to be consistent with overall deficit reduction targets.

- That the Bureau of Labor Statistics redefine and recalculate the medical care component of the Consumer Price Index to more accurately reflect price movements and true costs for all Americans of medical goods and services.

I. CPIs IMPACT ON THE ELDERLY

The elderly are more directly affected by changes in the Consumer Price Index (CPI) than any other group in the population. By statutory action income received by the elderly via Social Security benefits, military pensions, Federal Civil Service retirement and survivor benefits, and Supplemental Security Income payments are affected by movements in the CPI. Also affecting many elderly is the indexation of federal income tax brackets and exemptions. Low-income elderly are affected by adjustments in the food stamps program that are tied to changes in the CPI. And, the CPI is used to annually revise the official poverty threshold, thereby influencing the number of elderly below the poverty line.

A major concern of persons who are dependent upon income from government benefits and allowances is a gradual erosion of their purchasing power. If the CPI fails to reflect the price movements of items they purchase, then the recipients are unable to maintain their standard of living. If the opposite occurs, however, and their benefits are indexed to a CPI that overstates the changes in prices of the items they purchase, their economic well-being improves at a high cost to taxpayers.

AARP has a long-standing interest in the development of an accurate index for COLAs. Ever since the automatic COLAs were begun, AARP has been concerned that the COLAs are based upon expenditure patterns that do not reflect those of Social Security beneficiaries. AARP has always sought the use of the most accurate available measure for COLAs and believes that the CPI-U meets this criteria.

II. ORIGIN OF THE CPI

The CPI was first published in 1919 to help set new wage levels for workers in shipbuilding yards. The Consumer Price Index for Wage Earners and Clerical Workers (CPI-W) is based upon the spending patterns of households in which more than one-half of the household's income is earned from clerical or wage occupations and at least one of the earners has been employed for at least 37 weeks during the year. The CPI-W population includes 32 percent of the total U.S. population.

A broader-based CPI index was developed in 1978. The Consumer Price Index for All Urban Consumers (CPI-U) includes professional employees, the self-employed, the poor, the unemployed, and retired persons. It excludes persons in the military services, the institutionalized, and persons living outside urban areas. The CPI-U represents approximately 80 percent of the total noninstitutional civilian population of the United States. At the

time of its development, BLS planned to drop the old urban wage earners and clerical workers CPI (CPI-W). Since so many labor union contracts used the old CPI to escalate wages and since no one could project whether an index for all urban consumers would rise more or less rapidly than an index for wage earners and clerical workers, the old CPI series was retained.

III. HOW THE CPIs ARE CALCULATED

Data are collected from households throughout the United States to determine what they purchase. The households' expenditure patterns as collected in the Consumer Expenditure Survey (CEX) are used to determine the market basket of items that represent purchases of the average household. Another survey, termed the Point-of-Purchase (POP) survey, is used to determine where households purchase the market basket items. These items are priced monthly at outlets designated by the POP survey. Monthly changes in the item prices are used to calculate the official CPI.

In order to isolate price fluctuations from changes in living standards, the market basket remains fixed for a period of time. The market basket, however, needs to be periodically revised to reflect new purchase behaviors. To incorporate such changes, approximately every 10 years the BLS uses the CEX to develop a new market basket of goods and services.

In a major revision the expenditures are combined into categories which receive weights that adjust for specific factors. These include the number of consumer units in the United States, the change in the geographic distribution of the population as indicated in the last decennial census, the change in prices since the last revision, changes in category definitions, and changes in the quantities of the items that are consumed.

The weights, or "relative importance" of a component, are expressed as a ratio to the total. Relative importance ratios show approximately how the population distributes expenditures among the components. For example, a relative importance weight of 20 for food indicates that 20 percent of the average household's expenditures was spent on food, whereas 80 percent was spent on nonfood items.

IV. NEEDED CORRECTIONS TO THE INDEX

A. Medical care

AARP is very concerned about the manner in which the medical care component is defined. Medical care in the CPI only reflects out-of-pocket expenses for health-related commodities and services. This may have been appropriate several years ago before the widespread use of employer-paid health insurance plans, government supported health insurance programs (Medicare and Medicaid), and the wide availability of health maintenance organizations. As a result, the relative importance weight of medical care remains low because consumers have fewer out-of-pocket expenses.

The result of this definition is that although the inflation rate for medical goods and services has outpaced that for all items in the index, the large increases in medical care prices have a very limited affect on the general rate of inflation. Since older households spend proportionally twice as much on health care than the average household, it is crucial that the inflation of medical care be accurately represented in the CPI calculations.

Additionally, the medical care component incorporates all of the medical expenditures of uninsured consumers, but these consumers may not be receiving the medical care they need because of the high cost of these goods and services. Also, only the employee-paid portion of health insurance premiums are incorporated into the CPI. These health insurance calculations are questionable for the following reasons:

- A large portion of medical care expenses are not incorporated in the CPI since the employer-paid contributions for health insurance are considered income for the household. For example, if an employee has a pre-paid health insurance plan that costs the employer $200 per month, none of the medical care received by the family through the plan is included in the medical care component of the CPI.

- Only the portion of the premium which is paid directly by the insurer to health care providers or as reimbursements to policy holders is incorporated into specific medical care items. For example, if a worker only pays one-half of the total cost of the insurance premium, only one-half of the medical costs covered by the insurance policy are included in the CPI calculations. Secondary data are used for these calculations.

- The services of the insurance carriers in administering the policy are also indirectly calculated from secondary data. The health insurance subcomponent is the sum of all the retained earnings (premium revenue less benefit payment) of insurance carriers.

Another conceptual problem arises in how the costs of physicians' and hospital fees are determined in the monthly CPI item pricings. Physicians' fees are calculated from those paid by noninsured consumers only. Since 1985, BLS has been attempting to capture physicians' price discrimination (the practice of service providers charging different rates to patients covered by health insurance). Regardless of whether they charge uninsured patients higher or lower fees, the CPI medical care component does not reflect the prices paid to physicians. Price movements for hospital rooms are based upon published charges and are not collected from what consumers directly or indirectly pay.

Also, some medical services are not included in the medical component of the CPI. A new category was developed in the 1987 CPI weight revision to include the expenses paid for the care of invalids, elderly, and convalescents in the home. This category is located under housekeeping services in the housing component; therefore a major medical cost problem for older households is not reflected as such.

In its preliminary study of older Americans' purchasing behavior, BLS stated that older households have different illnesses, buy different drugs, have different insurance policies, and frequently see different medical specialists than the younger population. AARP agrees with BLS that a comprehensive reexamination must be done of the medical care component.

B. Housing

A major change was made to the housing component in the 1980s. The two CPIs showed volatility to interest rates as a result of the manner in which the home ownership component was constructed. The housing component was thought to overstate the housing cost of older households since they generally owned mortgage-free homes.

The rental equivalence method was begun for CPI-U in 1983; CPI-W was changed in 1985. The result of this change was a decline in the weight for housing and a redistribution of the weight to the other CPI components. The CPIs now produce a lower index when mortgage interest rates are increasing. This change is of particular interest now that the BLS has calculated the weights for the "experimental" index for those 62 and older (described in a later section of the testimony). The weights indicate that the homeowners' rental equivalence weight in the experimental index is much larger than that used in the CPI-U or CPI-W (a discussion of this is found in a later section of this testimony on the BLS experimental index).

In summary, AARP supports the research efforts of BLS to examine the medical care and housing components that are currently used in the CPIs. This effort is needed to strengthen the existing indices.

III. WHY THE CPI-U DIFFERS FROM THE CPI-W

Eleven years after the development of the CPI-U, one can observe differences between the general inflation rates as calculated from CPI-W and CPI-U (Table 1). With the exception of 1979, inflation as measured by CPI-U was the same or greater than inflation as measured by CPI-W.

Table 1. Consumer price indices by year, using annual averages.

Year	CPI-W	CPI-U
1979	11.5	11.3
1980	13.5	13.5
1981	10.2	10.4
1982	6.0	6.1
1983	3.0	3.2
1984	3.4	4.3
1985	3.5	3.6
1986	1.5	1.9
1987	3.6	3.6
1988	4.0	4.1

The reasons for differences between CPI-U and CPI-W center on the inclusion of retired persons in the CPI-U. BLS has identified six differences between the CPI-U and CPI-W populations (basic definitional differences were not included).

- CPI-U consumer unit is smaller in size because retired families are smaller,
- CPI-U reference person is older because of the inclusion of retired persons,
- CPI-U has fewer earners because retired persons are not in the labor force,
- CPI-U has a higher proportion of homeowners because of its higher average age of reference persons,
- CPI-U has a greater frequency of female reference persons because of women's greater longevity, and
- CPI-U has higher per capita income, but has a lower total income than CPI-W consumer units.

Reasons for difference in the relative importance weights of items in the CPI-U and CPI-W include the following:

- CPI-U has less importance on food at home because of smaller consumer unit sizes,
- CPI-U has more weight in the homeowner's equivalent rent component because consumer units in the CPI-U are more likely to be homeowners with homes of higher values than those in the CPI-W, and
- CPI-U has more weight on medical care because of the inclusion of retired persons and unemployed persons in the CPI-U. Out-of-pocket expenses are higher because employer paid health insurance is not available to many in the CPI-U. Also, the greater proportion of older persons causes more to be spent per capita on medical conditions associated with aging.

For these definitional reasons alone, the CPI-U is more appropriate than the CPI-W for COLA calculations. AARP urges Congress to have all federal agencies use the CPI-U in the determination of COLAs for government benefits and allowances.

VI. RESULTS OF THE BLS EXPERIMENTAL STUDY

In June 1988, BLS released its results from the study to determine the rates of inflation affecting Americans 62 years and older. These results confirm the widely held opinion that the CPI-U is the more appropriate measure of inflation of this population. As indicated in the Table 2, the relative importance weights of the CPI-U, rather than the CPI-W, are closer to the values of the experimental index weights (only those for December 1986 are shown). BLS concluded that "the experimental index, reweighted to incorporate the experience of older consumers, behaved more like the CPI-U than the CPI-W." Clearly the CPI-U should be used in the determination of COLAs for government benefits and allowances.

Table 2. Relative importance weights of major categories of expenditures, December 1986.

	CPI-W	CPI-U	Experimental index
All items	100.00	100.00	100.00
Food and beverages	19.45	17.66	15.62
Housing	39.95	42.48	48.47
Apparel and upkeep	6.36	6.34	4.66
Transportation	19.41	17.45	14.24
Medical care	4.95	5.83	9.38
Entertainment	4.04	4.37	3.36
Other goods and services	5.84	5.93	4.27

Source: Bureau of Labor Statistics, U.S. Department of Labor, "An Analysis of the Rates of Inflation Affecting Older Americans Based on an Experimental Reweighted Consumer Price Index," June 1988.

The discrepancy in the relative importance weights for medical care (3.55 percent) was fairly well expected from previous studies regarding a Consumer Price Index for the Elderly. What was surprising in the BLS preliminary study was the degree of difference in the housing component (5.99 percent). Previously, researchers thought that the rental equivalence correction would diffuse the impact of the purchase of homes on the rate of inflation and the resulting overcompensation of COLAs that resulted from home ownership of older households. But nearly one-half of the difference between the CPI-U and the experimental index is attributed to shelter which includes homeowners' equivalent rent. The finding that nearly one-half (48.47 percent) of the experimental index weight is assigned to housing costs is adequate evidence to merit further examination into definitional concepts used for housing. Perhaps a flow-of-services consumed concept is not appropriate for older households. These definitional problems need to be carefully addressed and studied by the research community.

The BLS evidence also suggests that the prices paid by older households may vary from the CPI-U population. When the weights were applied to the prices collected by BLS for the years 1983 through 1987, the results indicated that the experimental index rose 19.5 percent as compared with 18.2 percent for the CPI-U and 16.5 percent for the CPI-W. Although this specific 5-year time span covers a period of declining or stabilzed inflation, the differences suggest that older households have not been adequately compensated for the inflation they experienced since 1983.

One thing must be kept in mind, however. BLS was limited in its preliminary study by the data that were available at the time.

The market basket for an older household could not be accurately determined and priced according to the elderly's purchasing behavior. To do this the Consumer Expenditure Survey must be expanded to include enough older households to identify the accurate market basket. Then a Point-of-Purchase (POP) Survey must be conducted to determine where that population shops. Finally, these market basket items must be priced at outlets designated in the POP survey before calculations can be made for an index that measures the inflation experienced by older persons.

VII. USE OF CPI-W FOR COLAS

The United States Code does not specify a particular CPI for COLAs to government program benefits. For example, Section 8331(15) of title 5 defines the price index to be used as the "Consumer Price Index (all items--United States city average) published monthly by the Bureau of Labor Statistics" for Civil Service COLAs. In 1978 when the new CPI-U was begun, federal agencies were uncertain as to the future movement in it and chose to use CPI-W in their regulations concerning escalation of benefits.

In the 1980s when the CPIs were adjusted to correct the home ownership component problems, the U.S. General Accounting Office recommended that Congress change to the CPI-U for COLAs because CPI-U included retirees and incorporated the rental equivalence 2 years before the CPI-W. Calculations for the Social Security Administration found the CPI with the rental equivalence adjustment would be slightly lower than the former CPI. Again, the federal agencies chose not to change to the CPI-U for COLAs.

VIII. HOW THE COLAS WOULD DIFFER WITH THE CPI-U

Although the differences in inflation appear to be small, there are differences as shown in Table 3. Over time they have resulted in lower benefits for those who have been receiving checks since 1979. For instance the May 1979 average monthly benefit of $265.16 for retired workers in current payment status escalated to $481.60 by January 1, 1989 using the CPI-W. The same benefit would be $488.20 if CPI-U was used. Although this $6.60 per month difference may seem small, an accumulation of underpayment over 20 to 30 years of retirement could be quite substantial.

Table 3. Comparison of COLA calculations using CPI-W and CPI-U.

Date of COLA	Actual COLA (1967=100)	CPI-W	CPI-U (1982-84=100)	Difference
July 1979	9.9	9.9	9.7	-0.2
July 1980	14.3*	14.2*	14.3	0.1
July 1981	11.2	11.3*	11.2	-0.1
July 1982	7.4*	7.4*	7.6	0.2
January 1984	3.5	3.6	3.6	0.0
January 1985	3.5	3.5	4.3	0.8
January 1986	3.1	3.1	3.3	0.2
January 1987	1.3	1.3	1.6	0.3
January 1988	4.2	4.2	4.2	0.0
January 1989	4.0	4.0	4.1	0.1

Note: January 1984, January 1985, and January 1986 calculations are not comparable because of a change in rental equivalence for CPI-U in 1983-84.

*Actual COLAs do not agree with CPI-W column because of change in base years which causes rounding differences. These are calculated with appropriate quarter-to-quarter changes.

The use of CPI-U to adjust retirement benefits may have a minimal annual effect on the benefits of the average retiree, but the effect on government outlays could be substantial. Since the

COLAs using CPI-U has been higher than those with the CPI-W for four of seven COLAS (1984-86 are not directly comparable because of the rental equivalence delay), the costs of using the CPI-U for COLAs would be higher. For instance, each 1 percent change in the index triggered a $2.1 billion increase in costs for Old-Age, Survivors, and Disability Insurance (OASDI) January 1989 COLAs. The use of CPI-U would have cost an additional $2.1 million. The Social Security Administration actuaries do not see the need of a change in the long-range projections of the trust fund balances if COLA calculations used CPI-U rather than the CPI-W.

IX. COLA CALCULATIONS

In order to implement the COLAs on January 1 of the given year, a formula is used to calculate the rate of inflation as measured in the third quarter of the year. The average of seasonally un-adjusted monthly CPI-Ws for July, August, and September is divided by the average for those months in the prior year. The Association recommends that the COLA calculation be changed to incorporate a 12-month average instead of the 3-month average. Changing to a 12-month average will assure that the most accurate measure that is currently available will be used.

The 3-month average has its origin in the 1965 amendments to the Civil Service Retirement Act that triggered an increase whenever the CPI rose 3 percent above the level of the base month and remained at least 3 percent above the base level for three consecutive months. The pensions were to be escalated within two months after the end of the 3-month period. Although the timeliness of the COLAs changed to automatic annual adjustments, inflation as measured for a 3-month period remained in the calculations.

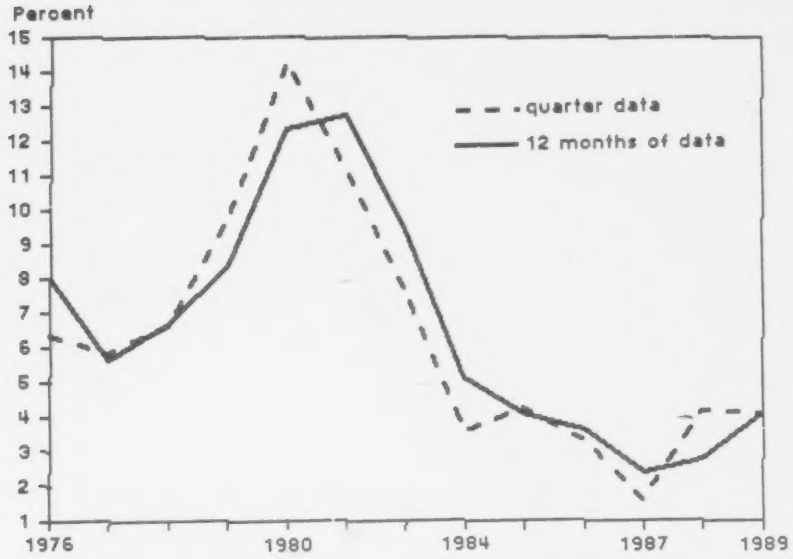
The present third quarter calculation does not use seasonally adjusted data. A 12-month average would correct this problem. Also it is no more difficult to calculate a 12-month average than it is to calculate a 3-month average. A 12-month average would permit recipients as well as program administrators to monitor over the year what the COLA will be in January. Currently, swings during the 3-month calculation period can skew the indexes and affect the COLA. As shown in the attached Chart, the discrepancy is considerable. In times of rapidly rising inflation, the 3-month average records a higher rate of inflation. The reverse is true when the rate of inflation is declining, such as was true in 1982 and 1983.

X. CONCLUSIONS AND RECOMMENDATIONS

AARP recommends that federal agencies change to the CPI-U in the determination of COLAs to government benefits and allowances. We also recommend that 12-month averages, ending with the third quarter, be used in the calculations. Prior to such implementation, the Social Security Administration, the Office of Management and Budget, and the Congressional Budget Office should provide impact analysis reports to the pertinent congressional committees on the use of CPI-U data and the use of 12 months of CPI indices for COLA calculations.

AARP recommends that the Bureau of Labor Statistics give priority to revising its concepts and calculations for the medical care component so it will be more representative of price movements for medical goods and services. This reconceptualization may lead to a series of experimental indices as was done to address the home ownership problems.

Consumer Price Index (CPI-U) Growth Rates Using Alternative Change Calculations



Calculated from monthly CPI-U data.
Quarter changes from 1976-84 are calculated with 1st quarter data;
1985-89 quarter changes use 3rd quarter data.
The 12-month changes end with the respective quarters.

Source: Bureau of Labor Statistics data
Prepared by AARP Public Policy Institute

Chairman JACOBS. Thank you, Mr. Zimmerman. Mr. Brown.

Mr. BROWN. Mr. Zimmerman, I just want to extend my thanks to you for your testimony today. I think it's very helpful to the committee. It gives some areas to work on.

Thank you.

Chairman JACOBS. I echo that gratitude, and admiration for the way you typed your testimony in narrow column form. It's very professional.

Mr. BROWN. In fact, very good.

Chairman JACOBS. You and I can both express our gratitude. So, thank you, sir, and I believe that concludes the hearing and makes us a lot smarter.

Thank you.

[Whereupon, at 11:20 a.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT BY BRUCE D. SCHOBEL TO THE SUBCOMMITTEE ON SOCIAL SECURITY, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, APRIL 26, 1989, REGARDING THE CONSUMER PRICE INDEX MEASURE USED IN CALCULATING SOCIAL SECURITY COST-OF-LIVING ADJUSTMENTS

Mr. Chairman and Members of the Subcommittee: My name is Bruce D. Schobel. I am Senior Consultant in the Social Security Division of Mercer Meidinger Hansen, the American operating company of William M. Mercer, Inc., the largest employee-benefits and compensation consulting firm in the world. I served in several actuarial and policy-related positions at the Social Security Administration during 1979-88, including a year as staff actuary to the National Commission on Social Security Reform and two years as Senior Advisor for Policy. Earlier, I spent four years with the Prudential Insurance Co. I am a Fellow of the Society of Actuaries, a Member of the American Academy of Actuaries and its Committee on Social Insurance, and a Chartered Life Underwriter.

In my statement, which follows, I show that the current use of the CPI-W for Social Security indexing purposes is not required by law, but rather, was a choice made late in the 1970s by the Administration. I recommend substituting the CPI-U, which is a broader measure more closely related to changes in the cost of living for Social Security beneficiaries. Such a change was nearly included in legislation enacted in 1988. I also show that the CPI-U would have produced larger cost-of-living benefit increases for Social Security beneficiaries, if it had been used instead of the CPI-W, beginning with 1978. However, I believe that the CPI-U may produce smaller cost-of-living adjustments in the future than will the CPI-W.

Historical Background

Automatic adjustment of Social Security benefits has been part of the law since 1972. The first automatic cost-of-living adjustment (COLA) was effective for June 1975. The procedure has been basically unchanged since then, with two exceptions. First, the effective date of Social Security COLAs was changed from June to December, beginning in 1983, under a provision of the Social Security Amendments of 1983 (Public Law 98-21). A corresponding change was made in the CPI-increase measuring period, from first-quarter-to-first-quarter, before 1984, to third-quarter-to-third-quarter, beginning with the COLA for December 1984. Second, the 3-percent "trigger," which never took effect, was repealed in 1986, so that a benefit increase will now occur if the CPI rises even 0.1 percent (after rounding).

The 1972 law did not specify a particular CPI to use for Social Security benefit-increase purposes, because only one CPI existed then. That CPI, renamed the Consumer Price Index for Urban Wage Earners and Clerical Workers, or CPI-W, was specified by the Administration in Social Security regulations (see 20 CFR 404.272(a)(1)) as the one to use for COLAs, but the law itself is still silent on the matter. The regulations could just as easily have specified the newer Consumer Price Index for All Urban Consumers, or CPI-U.

One limitation of the CPI-W is that it covers only 32 percent of the population, as noted by the Chairman's announcement of this hearing. Even worse, for Social Security indexing purposes, is that few of those covered are Social Security beneficiaries. In contrast, the CPI-U covers 80 percent of the population and a similar percentage of Social Security beneficiaries.

For several years, many observers have suggested developing an entirely new CPI for Social Security benefit-adjustment purposes. In 1987, Congress directed the Bureau of Labor Statistics (BLS) to study the concept of a special CPI, based on a market basket of goods and services purchased by the elderly (although not all Social Security beneficiaries are elderly).

The BLS report, issued in June 1988, emphasized the limitations of a special CPI for the elderly. On October 5, 1988, BLS Commissioner Janet Norwood testified before the Senate Special Committee on Aging and repeated the conclusions of the earlier report. She also indicated her willingness to do a more thorough, 3-year study of the matter, if such a study were requested.

In the meantime, the Senate adopted, as a compromise position, a provision that would have required all government agencies to use the CPI-U, rather than the narrower CPI-W, in all instances where they use the CPI for indexing purposes. (The Internal Revenue Code has for several years specified the use of the CPI-U for indexing the tax brackets, standard deductions, and personal exemptions, among other items. The indexing under the tax code is not otherwise identical, however, to that under the Social Security Act, in that the code uses the average of twelve monthly values for a fiscal year, rather than the average of three monthly values in a quarter.) This provision was included in the Senate's version of the tax technical-corrections bill late in 1988, but it was dropped in conference.

Past Experience of the Two Indices

During the period that the CPI-W and the CPI-U have existed simultaneously, they have been computed in a nearly identical manner, although based on differing market baskets of goods and services, of course. For two years, 1983-84, a more significant difference related to the way that home-ownership costs were reflected. The CPI-U was changed to a so-called "rental-equivalence" basis in 1983, while the CPI-W was not changed to the same basis until 1985. In all other years, any differences were due to changes in the prices of the two market baskets of goods and services, not differences in methodology.

The table below shows what the Social Security COLAs were, using the CPI-W, and what they would have been, using the CPI-U, since 1978:

Effective date	COLA, based on		Cumulative, based on	
	CPI-W	CPI-U	CPI-W	CPI-U
June 1978	6.5%	6.6%	6.5%	6.6%
June 1979	9.9	9.8	17.0	17.0
June 1980	14.3	14.3	33.8	33.8
June 1981	11.2	11.2	48.8	48.8
June 1982	7.4	7.6	59.8	60.1
Dec. 1983	3.5	3.6	65.4	65.8
Dec. 1984	3.5	4.2	71.2	72.8
Dec. 1985	3.1	3.4	76.5	78.7
Dec. 1986	1.3	1.6	78.8	81.5
Dec. 1987	4.2	4.2	86.3	89.2
Dec. 1988	4.0	4.1	93.7	96.9

The table shows that the CPI-W and the CPI-U have moved virtually in tandem, except for the period when the differing treatment of home-ownership costs had an effect. Over the entire period, the CPI-U increased by about 3 percent more than the CPI-W (97 percent compared to 94 percent). Can this be expected to continue?

I believe that the prices of two basically similar market baskets of goods and services cannot increase at substantially different rates for any extended period of time. If one increases more than the other for several years, then the other can be expected to catch up. If this theory is correct, then the CPI-W may be expected to increase more rapidly than the CPI-U in the near future. We may be seeing evidence of this change already.

Recent Experience

On April 18, the Bureau of Labor Statistics released the Consumer Price Index figures for March 1989. The CPI-W rose at a 6-percent annual rate in March. Since the third quarter of 1988, which is the most recent cost-of-living computation quarter for Social Security benefit increases, the CPI-W rose at a 5.1-percent annual rate, seasonally adjusted. If the CPI-W continues to rise at this rate for six more months, through the third quarter of 1989, then the December 1989 Social Security COLA will be 5.1 percent--the largest COLA since 1982. The relevant figures are shown below:

Period	CPI-W	Seas. Adj. Factor	Adjusted CPI-W
7/88	117.2	1.00000	117.2
8/88	117.7	1.00000	117.7
9/88	118.5	1.00339	118.1
3rd Quarter/88	117.8	n/a	117.6667
10/88	118.9	1.00253	118.6
11/88	119.0	1.00000	119.0
12/88	119.2	.99916	119.3
1/89	119.7	.99750	120.0
2/89	120.2	.99751	120.5
3/89	120.8	.99752	121.1

Period	Annual Rate of Increase for Period	
	Unadjusted Basis	Adjusted Basis
3rd Quarter/88 through 3/89	4.4%	5.1%
2/89 to 3/89	6.2	6.1

The CPI-U, however, did not rise quite as much. On a seasonally-adjusted annual basis, the CPI-U increased 5.0 percent from the third quarter of 1988 through March 1989. Actually, the difference is not as large as the apparent 0.1 percent, which looks larger than it is due to rounding; the unrounded difference is 0.01 percent. Although this difference is small, it may indicate that the CPI-W is catching up to the CPI-U, which had been rising more rapidly in recent years.

If this trend continues, then Social Security beneficiaries may get the worst of both worlds: They may get COLAs based on the CPI-W when the CPI-U would have produced higher ones, and they may get COLAs based on the CPI-U when the CPI-W would have produced higher ones. On the other hand, the differences are quite small, even when compounded over a number of years. Those who support replacing the CPI-W with the CPI-U, as I do, are not motivated by the small 3-percent higher cumulative benefit increase that would have occurred if the CPI-U had been used since it first appeared. Rather, the CPI-U is more appropriate because it better represents changes in the prices of goods and services purchased by Social Security beneficiaries.

NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
1533 New Hampshire Ave., N.W., Washington, D.C. 20036-1279 (202) 234-0832

H. T. STEVE MORRISSEY, President
H. L. "RIP" RIPPLE, Vice President
HAROLD "HAL" PRICE, Secretary
BENNY L. PARKER, Treasurer

STATEMENT OF
THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
BEFORE THE
SUBCOMMITTEE ON SOCIAL SECURITY
COMMITTEE ON WAYS AND MEANS
ON
THE CONSUMER-PRICE-INDEX MEASURE USED IN
CALCULATING SOCIAL SECURITY COST-OF-LIVING ADJUSTMENTS

APRIL 26, 1989

The National Association of Retired Federal Employees has a dues-paying membership of over 500,000 retired persons and represents the concerns of two million federal annuitants. We welcome this opportunity to express our views on the need for a consumer price index which accurately reflects and weighs the spending patterns of older Americans.

Looking at what older Americans purchase and utilizing an index that more accurately reflects their spending habits is sound public policy which we support.

Our Association has repeatedly advocated that Congress authorize a separate CPI for the elderly that would be used to calculate the rate of inflation for adjustments in retirement programs on the basis of the elderly's consumption patterns. Older Americans spend far greater portions of their limited resources on basic core necessities -- food, energy and medical care -- than their younger, working counterparts.

We believe protection of the full purchasing power of earned retirement income is the most significant component of the Federal Government's retirement policies. The income of the average worker drops dramatically at the time he or she retires. Most retirees are unable to return to the work force to earn additional income during hard economic times. Thus, their retirement income is basically fixed and maintaining the purchasing power of those dollars is of paramount importance.

The controversy today centers around the fact that retirement benefits, when indexed for inflation, are adjusted on the basis of a price index that reflects the buying habits of urban wage earners and clerical workers -- only 40 percent of the population. Retirement cost-of-living adjustments (COLAs) are tied to this index, known as the CPI-W, because that was the standard measure in use when automatic benefit indexing was introduced as a means of establishing a consistent approach to inflation protection that would not be subject to annual, or election year, political machinations.

In 1978, the all urban CPI-U was developed. Because it surveys the spending patterns of a much wider spectrum of consumers, including retirees, it presents a more accurate picture of overall inflation than the CPI-W. Legislation has subsequently been passed to specify the CPI-U as the measurement for indexing some Federal programs. However, in spite of the assessment of the General Accounting Office and others, that the CPI-U provides a more accurate and reliable measure for retiree spending, the CPI-W remains the implementing index for all Federally-administered retirement programs.

We believe that for this purpose, the CPI-W is flawed. As it does not survey any retirees, it cannot accurately reflect the inflation that this group of Americans experiences. The necessities of life represent a sizeable chunk of an annuitant's fixed income. Expenditure categories such as medical care, energy costs, and food account for a greater share of the elderly's total income than their weight in the CPI-W. Medical care costs alone affect the elderly more than their overall impact on younger consumers. And unfortunately, inflation in the medical care component of the index has continued to spiral, even as inflation as a whole has moderated.

In addition, the CPI-W does not reflect the differing kinds of goods and services that the elderly purchase. Nor does it take into account where they purchase these goods and services. Older Americans often lack the mobility to comparison shop. Without this mobility, they are often forced to shop for food and necessities at locations that traditionally do not offer competitive prices.

Because the current CPI-W does not weigh medical care, and other basic necessities according to retirees' spending patterns, older Americans are losing confidence in the index as a measure of the inflation they are experiencing. Some even suspect government manipulation of surveyed costs as a way of holding down inflation adjustments. Most retirees simply do not realize or understand that their own spending is not included in the survey used to index their retirement dollars.

NARFE believes that retiree spending must be included in any index used for calculating retirement COLAs. Certainly, the current CPI-U is a better gauge of inflation for this purpose than the CPI-W. We would welcome and encourage a Labor Department study on a special CPI for the elderly. We applaud your efforts to begin such a study to find a measurement that more accurately reflects the spending habits of the elderly.

While any CPI is going to be flawed in some respect, the best we can hope to achieve is an index which accurately reflects the spending habits of those it seeks to protect. We are not seeking higher inflation adjustments than we deserve -- we seek only an honest calculation that will maintain the purchasing power of the earned retirement dollars of older Americans.

But in the final anylysis, NARFE maintains that security is the bottom line. Whatever the technicalities of the survey and weighings used for measuring inflation, the Federal Government must live up to its commitment to protect the purchasing power of retirement income from the ravages of inflation. While we appreciate this opportunity to present our views on a separate or new inflation index for the elderly, our larger concern is that Congress, through this proces, recognize the equally pressing need for reliability and consistency in its inflation protection policy.

In this decade, all retirees have witnessed an erosion of their inflation protection in the name of fiscal restraint. But Federal retirees have lost more than others. And all too often, political expediency rather than fiscal responsibility has been the culprit. And while the budget resolution adopted by Congress last week assumes fully indexed COLAs for all Federal retirees in the coming fiscal year, few are reassured of this continued inflation protection. Between the first quarter of 1983, and the third quarter of 1988 (the last base index period), inflation rose 19.9 percent. All retirees lost some of that inflation protection as a result of a one-time delay in payments. But civil service retirees, through a delay, a reduction, and finally total elimination of their promised COLAs, have had increases totalling only 13 percent for the measured 19.9 percent inflation. They have had to absorb 35 percent of measured price increases since the beginning of 1983. And they have been forced to constantly do battle for the 65 percent inflation protection they did receive.

Despite what many would have you believe, civil service retirement benefits are modest. The average annuitant receives $1146 per month, while survivor annuities average $552 per month. And since these annuities are subject to income tax, the real dollar gain of COLAs is less for these annuitants than for retirees with full or partial tax exemption status.

Therefore, we seek a more accurate method of surveying and weighing the consumer prices of the nation's elderly to enhance and restore their confidence in the validity of the index, but we also believe that their confidence in the commitment of the government to protect them from the erosion of inflation must be restored. For in the end, it makes no difference what CPI measurement is used unless there is a guarantee of protection against that inflation.

STATEMENT OF MARTHA McSTEEN, PRESIDENT, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

I am Martha McSteen, President of the National Committee to Preserve Social Security and Medicare.

Many of our five million members and supporters, like most Social Security recipients, rely on Social Security for more than half of their retirement income. But even for those members with substantial additional resources, Social Security is likely to be the only part of their retirement income which is protected against the ravages of inflation. It is this reliance on Social Security by all beneficiaries which makes it essential that annual Cost-of-living Adjustments, (COLAs) reflect as accurately as possible the impact of price changes that affect Social Security beneficiaries.

We do not believe that either of the Consumer Price Indexes (CPIs) now used by the Bureau of Labor Statistics accurately reflects changes in the cost-of-living for older Americans. Had an experimental index, reweighted to reflect the spending requirements of older Americans been used for the COLA for the five year period from December 1982 to December 1987, the average Social Security beneficiary would have received an additional $528 in benefits.

For this reason, the National Committee to Preserve Social Security and Medicare supports research on how the typical market basket of goods and services purchased by seniors differs from those of other consumers. If, as preliminary research suggests, differences are significant, we advocate the development and maintenance of a separate Consumer Price Index for seniors to be used to determine the Social Security COLA.

Seniors are far from a monolithic group in income or interests. Understandably, there are major differences in purchases by affluent seniors compared to seniors at or close to the poverty level. Still the similarities in buying patterns of seniors at different income levels may be more significant than their differences. And seniors, overall, may have different purchasing patterns than younger individuals and families. Until there is more research, we simply do not know enough about the buying patterns of seniors, as a group, to be confident that the present method of setting COLAs is adequate to protect purchasing power.

Preliminary research by the Bureau of Labor Statistics has found that the index currently used to set retiree COLAs, the CPI-W, is not the proper tool. The CPI-W covers only 32 percent of the population, all of whom are currently in the work force. The households of urban wage earners and clerical workers, whose market basket of goods and services is measured by the CPI-W, are markedly different than senior households. And their spending patterns reflect those differences.

Younger families who are a proportionately larger segment in the CPI-W spend more for food, apparel, entertainment, and transportation, but less than older Americans for housing, fuel oil and medical care. Younger families, particularly two-earner families, are more frequent users of restaurants and convenience stores. But, because their households are larger, they have the advantage of economies of scale in making purchases. Younger individuals generally have the ability to do their own home upkeep and repairs, if they so choose. Older Americans frequently have no choice.

And these are just some of the most obvious differences. Medical care is the single most important difference in a spending comparison between the households measured by CPI-W and older Americans.

Mr. Thomas E. Sage of San Diego, California, wrote us when the Medicare Catastrophic Act was reported in his local news media.

"My Government Wide Health Insurance was increased this year from $39.99 per month to $86.55 per month. That is an increase of 116.43 percent. I will bet a hat that was not considered in the COLA that was given. Also the medical bills have risen and the hospital qualification amount. Now they are talking about increasing the cost of Medicare. If they keep on helping us senior citizens out, in a few years we won't be able to make ends meet at all."

The overwhelming impact of rising medical costs was also on the mind of W. O. Bill Fordyce of Sherman,Texas, who wrote just after this year's four percent COLA was announced.

"This past January we got a 4.2 percent increase on Social Security. My wife is not yet on Medicare and her hospitalization premium went up 100 percent last year and another 60 percent this year. My Medicare supplement went up 38 percent. Beef has gone up from 35 to 100 percent this year. Even toilet tissue has gone up over 30 percent. Now how can a four percent COLA even come close?"

COLAs will never keep up with increases in medical costs unless and until medical inflation is brought under control. But, according to the Bureau of Labor Statistics, this single component accounted for more than half of the difference between the spending patterns of older Americans and the different populations measured by the two official indexes. And BLS freely admits it does not know if the kinds and frequencies of medical services used by seniors are comparable to those used by the other measured populations.

But while we wait for additional research on a more appropriate Consumer Price Index based on the market basket of goods and services used by seniors, we have readily available a better measure which can be used to adjust COLAs. The CPI-U, which measures the purchasing patterns of all urban residents, including seniors, and covers eighty percent of the population has already been shown to be more representative of price changes in goods and services purchased by seniors than the CPI-W.

BLS reported last October that over the five year period from December 1982 to December 1987, an experimental index developed to measure CPI changes for older Americans rose 19.5 pecent. The CPI-W used to set COLAs rose only 16.5 percent, while the CPI-U rose 18.2 percent. Had Social Security recipients on the beneficiary roles in 1982 received increases based on the experimental index during this period, the average beneficiary would have received an additional $528 in Social Security benefits.

The Office of Management and Budget last fall discounted the importance of a change from the CPI-W to the CPI-U because last year's difference would have amounted to only $6.00 a year to an average beneficiary. But for most beneficiaries, every dollar counts. Even $6.00 a year would have helped beneficiaries pay for rising Medicare Part B costs, for example. The cumulative impact over time is even more significant because the $6.00 would be included in the base for each future COLA.

Mr. Chairman, the National Committee to Preserve Social Security and Medicare believes that this country has an obligation to use the very best measure we have to set annual COLAs. Until a special index is developed for the elderly, the CPI-U is the most appropriate. We urge this Subcommittee to mandate the use of this broader based measure of price changes in the economy when computing the Social Security COLA.

DAVID PRYOR, ARKANSAS, CHAIRMAN
JOHN GLENN, OHIO
BILL BRADLEY, NEW JERSEY
QUENTIN N. BURDICK, NORTH DAKOTA
J. BENNETT JOHNSTON, LOUISIANA
JOHN B. BREAUX, LOUISIANA
RICHARD SHELBY, ALABAMA
HARRY REID, NEVADA
BOB GRAHAM, FLORIDA
HERBERT KOHL, WISCONSIN
JOHN HEINZ, PENNSYLVANIA
WILLIAM S. COHEN, MAINE
LARRY PRESSLER, SOUTH DAKOTA
CHARLES E. GRASSLEY, IOWA
PETE WILSON, CALIFORNIA
PETE V. DOMENICI, NEW MEXICO
ALAN K. SIMPSON, WYOMING
JOHN WARNER, VIRGINIA
NANCY LANDON KASSEBAUM, KANSAS
PORTIA PORTER MITTELMAN, STAFF DIRECTOR
CHRISTOPHER C. JENNINGS, DEPUTY STAFF DIRECTOR
JOSEPH A. LIEBERMAN III, M.D., ACTING MINORITY STAFF DIRECTOR

United States Senate
SPECIAL COMMITTEE ON AGING
WASHINGTON, DC 20510-6400

STATEMENT OF

SENATOR DAVID PRYOR
Chairman
Senate Special Committee on Aging

Submitted to

SUBCOMMITTEE ON SOCIAL SECURITY
COMMITTEE ON WAYS AND MEANS

With regard to

THE CONSUMER PRICE INDEX USED IN CALCULATING SOCIAL SECURITY COST-OF-LIVING ADJUSTMENTS

April 26, 1989

Mr. Chairman, I appreciate this opportunity to express my concern over the consumer price index (CPI) currently used to formulate the Social Security cost-of-living adjustment (COLA). I commend the distinguished Chairman for holding this timely hearing.

Americans across the country assume that the federal government is using the most accurate CPI available for indexing Social Security and other federal retiree, survivor and disabled benefits to the rate of inflation. Unfortunately and surprisingly, we are not. In fact, the CPI used for COLA calculations, known as the CPI-W, does not survey a single retired or severely disabled person.

Most older and disabled Americans live on a fixed income, making a COLA that offsets the effects of inflation on the purchasing power of Social Security benefits and other federal retirement, disability and survivor programs of vital importance. However, because the CPI-W only surveys the working population, a great deal of doubt has been cast on its reliability for this purpose.

Many also are unaware that a much more broadly based index -- namely, the the CPI-U -- exists that includes retirees and disabled individuals in its survey. In fact, while the CPI-W covers about 23 percent of the population, the CPI-U is representative of about 80 percent.

On April 19, 1989, I introduced S. 864 to ensure that federal agencies use the broadest and most fair CPI available to calculate COLAs for benefits under Social Security, Civil Service, Railroad Retirement, Military retirement, and other federal income security programs. This bill would simply require that the CPI-U be used in place of the CPI-W for indexing such programs.

There is no reason to assume that older and disabled Americans have the same buying patterns as the rest of the population. For example, few would dispute the fact that, on average, the medical needs of those 65 and older are far greater than for the rest of the population. If the inflation rate for these services paralleled the overall inflation rate, there would be less reason for concern. Unfortunately, the medical inflation rate each year has risen higher and faster than has the general inflation rate. In fact, a recent Bureau of Labor Statistics (BLS) study showed that Americans 65 or older appear to have experienced higher inflation than has the rest of the nation in the last five years. BLS also found that higher medical and housing costs appeared to be the primary factors at work.

Furthermore, at a 1988 Aging Committee hearing on the advisability of replacing the CPI-W with the CPI-U, BLS Commissioner Janet Norwood noted that "Social Security recipients have expenditure patterns most like older consumers and more similar to those of the CPI-U households than to those of the CPI-W." At the same hearing, as well as in a 1982 report, the General Accounting Office recommended using the CPI-U for COLA calculations.

OMB also recommended in 1980 that the CPI-U replace the CPI-W for COLA calculations. In the words of then-director of OMB, James T. McIntyre:

> The new "all urban" index [CPI-U], in doubling the population covered compared with the current index, will include retirees and other recipients of Federal program benefits that are adjusted by the CPI, but who are not represented by the current index. It will thus not only reflect more accurately the changes in prices experienced by a larger proportion of the population, but will be a more appropriate base of adjustment of Federal benefits than the much more limited "wage and clerical" index [CPI-W] in current use.

Both CBO and OMB view this measure as budget neutral. Contrary to its 1980 position on this issue, however, OMB did not support similar legislation offered in the last Congress by the former Senate Aging Committee Chairman. This is because OMB felt that COLA's would be virtually unchanged under the CPI-U and that therefore this legislation was not needed. It is my hope that this year OMB will change its position.

Under S. 864, COLA's for Social Security and other federal retirement and income support programs may or may not change under S. 864. However, they will be more accurate and fair. In the two years that the Senate Aging Committee has been looking into this matter, we have heard nothing to contradict this statement.

I believe, as do many others, that the CPI-U provides a more accurate measure of the inflation rate experienced by elderly and disabled individuals than does the CPI-W. S. 864 would ensure that the millions of elderly and disabled Americans who depend on Social Security, veterans pensions, and other federal income support programs are provided with the most accurate COLA possible.